V I C T O R I A

Auditor-General
of Victoria

REPORT ON MINISTERIAL PORTFOLIOS

MAY 1999

Ordered to be printed by Authority.
Government Printer for the State of Victoria

No. 56 - Session 1998-99

ISSN 1033 2960
ISBN 0 7311 5501 7

May 1999

The President
The Speaker

Parliament House
Melbourne, Vic. 3002

Sir

Under the authority of section 15 of the *Audit Act* 1994, I transmit my Report on Ministerial Portfolios. The Report also contains a section on the Parliament of Victoria.

This Report completes the cycle of my auditing activities in relation to the 1997-98 financial year.

Yours faithfully

C.A. BARAGWANATH
Auditor-General

Contents

Foreword

This is my 11th and final *Report on Ministerial Portfolios* since assuming office on 30 August 1988. I will be retiring on 30 July 1999 and it has been a privilege to serve Parliament and the community over the last 10 years.

During that period, there has been a quiet revolution in financial management within the Victorian public sector - not only in the inner budget area but also in areas such as local government. Among the many reforms in recent years have been the long overdue introduction of accrual accounting by Government departments, a reform advocated by many of my predecessors, introduction of accrual-based appropriations, an increased focus on output-based management and the presentation to Parliament of audited whole-of-government accounts for the first time in 1997. These reforms will enhance the future capacity of Parliament and the community to monitor and assess the performance and financial standing of the Government and its various agencies.

Another significant initiative largely introduced by the current Government is the contracting out of services previously provided by the public sector. While savings may be generated and service levels may be improved by contracting-out, it has, from my perspective, produced one highly undesirable and time-consuming by-product, namely, the necessity to continually counter claims that information I intend to include in my Reports to Parliament is commercially confidential. There appears to be a widely held belief, particularly prevalent among senior bureaucrats, that financial arrangements with the private sector should be shielded from parliamentary and taxpayer gaze.

Unless Parliament is provided with appropriate information, its capacity to exercise its constitutional right to monitor the operations of the Executive will be restricted, and accountability and good governance in Victoria may be irreparably harmed.

Finally, substantial progress has been made by my Office in addressing many of the not inconsiderable transitional difficulties associated with the new audit regime introduced on 1 July 1998. While these measures were introduced in the expectation that more extensive use of competition is likely to lead to better outcomes and improved public audit services to the Parliament and auditees, I note that in its Report of April 1997, the Audit Act Review Team concluded that:

> "*It would be appropriate to review the arrangements after say, three years, to determine whether legislative and other amendments would improve public sector external audit arrangements*".

In my opinion it is imperative for Parliament to closely monitor the outcome of the revised audit arrangements and, if dissatisfied with the output of the Office in future years, to revisit the legislation. Personally, I remain pessimistic as the likelihood of maintaining sufficient skilled resources and being provided with adequate funding to discharge the important responsibilities envisaged by the new legislation.

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.

EDUCATION **Page 19**

Development of University IT systems - the CASMAC project

- The CASMAC project which cost Victorian participating universities well in excess of $4.3 million was abandoned by the participating universities mainly due to the inability of the contractor to deliver the required software according to the specifications and the contract, and logistical problems arising from the involvement of such a large number of participants in the decision-making process.

Paras 3.1.4 to 3.1.17

Use of computers in primary schools

- The Government has been proactive in its endeavours to provide State primary students with IT resources for learning, through increased funding and the establishment of strategies and targets to achieve specific outcomes.

Paras 3.1.23 to 3.1.28

- While a target of one computer for every 5 students on average has been established for achievement by both primary and secondary schools by June 2000, audit identified that the current ratio was only one computer to every 9.8 primary school students in the regions surveyed by audit, with variations existing between individual schools.

Paras 3.1.37 to 3.1.53

Utilisation of consultants and contractors by the Department of Education

- Approximately 40 per cent of contractors selected for audit review were not subject to competitive and public tendering by the Department.

Paras 3.1.74 to 3.1.82

- To enable proper accountability and justification of decisions to engage consultancy and contractor services, it is imperative that agencies apply the spirit of competitive selection principles. Unless alternative service providers are sought to expand the available market, the expertise will always remain with the same contractors who will continue to be appointed without competitive tendering for projects.

Paras 3.1.83 to 3.1.84

HUMAN SERVICES Page 57

Accountability of community health centres

- As community health centres become larger and responsible for the management of increasing levels of public resources, consideration needs to be given to their level of accountability to the Parliament and ultimately to Victorian taxpayers. As the Parliament's auditor, it will be important that the Auditor-General is involved in this accountability process.

Paras 3.2.15 to 3.2.19

Financial viability of public hospitals

- An analysis of the financial viability of public hospitals as at 30 June 1998 revealed:
  - 60 hospitals (66 per cent) incurred a deficit, prior to grants received for capital purposes and transactions of an extraordinary nature;
  - 26 hospitals (28 per cent) had generated negative cashflows from their operating activities; and
  - 35 hospitals (38 per cent) had a negative working capital position.

Paras 3.2.35 to 3.2.37

- In relation to the public hospitals showing signs of financial difficulty as at 30 June 1998, the Department has advised that the financial position of certain of these hospitals had subsequently improved. It is the Office's intention to review the financial position of these hospitals as at 30 June 1999, based on audited information.

Paras 3.2.41 to 3.2.44

Maintenance of public housing

- Based on the departmental advice that the information recorded on its housing portfolio maintenance database is out-dated, there is a clear need for the Department to establish appropriate information systems which record reliable information on the condition and future maintenance requirements of its property portfolio.

Paras 3.2.61 to 3.2.63

Condition of residential care facilities

- As at February 1999, Commonwealth Government certification had been obtained for 164 residential care facilities as providing accommodation that meets the established standards. However, 23 facilities containing 1 224 beds were yet to meet the certification standards.

Paras 3.2.69 to 3.2.72

- The Department advised that the major reasons for facilities not meeting the Commonwealth Government certification process were the failure to meet fire safety standards, poor privacy standards, and the age and out-dated design of facilities.

Paras 3.2.73

Results of police and legal investigations into contractual practices at metropolitan ambulance service

- While a judicial inquiry did not eventuate, I do draw comfort from the fact that senior legal counsel, expert police investigators and an experienced financial accountant formed views of the seriousness of the situation at the Metropolitan Ambulance Service which mirrored my own and those of my staff.

Paras 3.2.107 to 3.2.112

INFRASTRUCTURE Page 99

Public transport reform

- The average estimated cost recovery of the public transport train and tram passenger businesses in the 1998-99 financial year will be around 55 per cent, representing a total shortfall of earnings before interest, taxation and abnormal costs of $284 million.

Paras 3.3.4 to 3.3.9

- In September 1998, a consultant engaged by the Government concluded that the country intrastate rail infrastructure was basically fit for freight and passenger operating purposes, but a maintenance backlog in the order of $23 million was identified, with backlogs identified in all transport corridors.

Paras 3.3.27 to 3.3.30

Public transport fare evasion and revenue protection

- Transport surveys identified fare evasion on train services of 7.6 per cent on weekdays and 16.9 per cent during weekends, and fare evasion on tram services of 5.8 per cent on weekdays and 10.3 per cent during weekends.

Paras 3.3.38 to 3.3.58

- In the period from November 1998 to February 1999, around 240 items of automated ticketing system (ATS) equipment, mainly dispensers, were damaged by corrosive liquid attacks at 142 metropolitan rail stations and 39 dispensers were damaged by other means. During this period, the Public Transport Corporation paid $3.4 million to security firms engaged to protect the ATS dispensers. The Corporation has been unable to provide a specific estimate of the loss of fare revenue collections resulting from the non-operation of the ATS equipment.

Paras 3.3.59 to 3.3.65

Melbourne City Link extension project

- The audit analysis of the arrangements associated with the development and operation of the *City end* of the Exhibition Street extension concluded that the State has accepted the construction risk, however by virtue of the payment of an expected contract sum of $37.5 million by Transurban to the State upon completion and delivery of the *City end* of the extension, the State aims to recoup the total cost of its design, construction and delivery.

Paras 3.3.89 to 3.3.97

Maribyrnong Council - operating lease payout

- The City of Maribyrnong will incur total cash outflows of $39 million, comprising a termination payment of $24 million and future interest charges of $15 million, to terminate an onerous leasing arrangement associated with a building constructed as part of the Quay West Project. In essence, the City is committed to a substantial outlay of funds to the year 2012 which will provide no real benefit to ratepayers because of unsound business decisions made in the past in the area of the City's non-core activities.

Paras 3.3.167 to 3.3.179

INFRASTRUCTURE - *continued* Page 99

Docklands redevelopment

- The Docklands Stadium arrangements require the State to provide trunk infrastructure valued at $61.5 million which will provide benefits for the whole of the Docklands but which is critical for the Stadium, and to provide 7.2 hectares of land. In addition, the State has accepted certain defined risks in order to facilitate private sector construction, financing and ownership of the Stadium. Ultimately, under the Stadium arrangements the State will receive $33.7 million from the private sector, not including the economic benefit to be derived from the Stadium development and operation.

  Paras 3.3.233 to 3.3.251

- To enhance the development prospects of the new Docklands Stadium, as part of the arrangements for its development the Authority entered into a user agreement with the Australian Football League.

  Paras 3.3.243 to 3.3.248

- As part of the arrangements for the Stadium, the developer provided finance of $29.1 million to the Authority. However, the Authority did not obtain the required prior formal approval from the Treasurer for the loan, as required under the *Borrowing and Investment Powers Act* 1987.

  Paras 3.3.243 to 3.3.244

JUSTICE Page 183

Victoria Legal Aid - Funding changes

- Although Victoria Legal Aid (VLA) had no control over the Commonwealth Government decision to reduce legal aid funding, the impact of the decision was to reduce the community's access to legal aid, which is in direct conflict with one of VLA's primary objectives of providing the community with improved access to justice and legal remedies.

  Paras 3.4.21 to 3.4.24

- The audit review of a sample of legal aid applications revealed that, generally, there was no evidence on client files to support the decisions made regarding the merits test. As a result, audit was unable to determine whether all aspects of the Commonwealth and State merits tests had been appropriately applied.

  Paras 3.4.36 to 3.4.47

- VLA should undertake an assessment of need for legal aid within the Victorian community to assist it in allocating scarce legal aid funding in the most effective and equitable manner, and to determine the impact of changes to legal aid guidelines on the provision of legal aid services in Victoria.

  Paras 3.4.57 to 3.4.62

JUSTICE - *continued* Page 183

Urgent need for enhanced public accountability covering non-judicial functions of Victorian courts

- I have been forced to curtail the scope of several audits of administrative functions within judicial bodies since June 1996 because of legal advice provided to the Department of Justice at the time of my proposed tabling of the Children's Court performance audit.

Paras 3.4.83 to 3.4.84

- The developments that have transpired on this matter are totally unsatisfactory in terms of the serious public accountability implications to the Parliament and the community.

Paras 3.4.85 to 3.4.87

NATURAL RESOURCES AND ENVIRONMENT Page 219

Water quality

- The microbiological quality of water in the Melbourne metropolitan area was assessed to be of a very high standard.

Paras 3.5.12 to 3.5.37

- As at 30 June 1998, around 40 per cent of country Victorians were still in receipt of drinking water which did not meet the microbiological requirements of the established guidelines and the level of compliance was 10 per cent lower than that projected by the Department of Natural Resources and Environment to be achieved by the end of 1999.

Paras 3.5.12 to 3.5.37

- While Melbourne Water and the 3 metropolitan retail water companies have in place emergency management plans, in excess of half of the 15 non-metropolitan water authorities had not finalised their plans.

Paras 3.5.46 to 3.5.49

Sewerage treatment in non-metropolitan urban water industry

- Around 28 per cent of wastewater treatment plants fully met the standards outlined in the related EPA licence compared with only 13 per cent in the 1996-97 financial year.

Paras 3.5.60 to 3.5.66

- While the audit review concluded that progress was made during the 1997-98 financial year in the compliance of non-metropolitan water authority wastewater treatment plants with licensing conditions, significant improvement in compliance will only occur following the completion of major upgrades to treatment plants which are currently in progress.

Paras 3.5.60 to 3.5.66

NATURAL RESOURCES AND ENVIRONMENT - *continued* Page 219

Restoration of mining sites

- As a result of delays in undertaking inspections of mining sites, the Department cannot be assured that mining operators have rehabilitated sites in accordance with approved work plans and within a reasonable timeframe.

Paras 3.5.109 to 3.5.124

- Given the potential safety risk to the community of unrehabilitated old mined or excavated sites, it is important that the Department identify and complete their restoration as soon as possible.

Paras 3.5.109 to 3.5.124

PREMIER AND CABINET Page 275

Museum development project

- The Melbourne Museum complex which was originally estimated to cost $250 million has now been revised to cost $287.6 million at completion, with the increase mainly attributable to a change in scope of the complex, lack of detailed costings relating to the public exhibition program, and problems encountered with the treatment and removal of contaminated soil and water seepage not envisaged prior to the commencement of the excavation works.

Para. 3.6.23

- While the IMAX theatre became operational in May 1998, audit has been unable to determine whether revenue earned from the theatre has met expectations to date due to the management of Museum Victoria refusing to provide audit access to this information on account of commercial-in-confidence considerations. In my view, the position taken by management is inappropriate and should not be acceptable to the Parliament as it prevents independent assessments on behalf of Victorian taxpayers of the financial status of this arrangement.

Paras 3.6.40 to 3.6.44

TREASURY AND FINANCE — Page 295

Sale of Victorian Plantations Corporation

- The proceeds received by the State from the sale of the Victorian Plantations Corporation's (VPC) net assets were around $201 million in excess of the book value of the plantation business, mainly representing the value placed by the purchaser on the perpetual rights granted by the State in relation to the occupation and management of Crown land vested in the VPC for plantation purposes.

Paras 3.8.38 to 3.8.42

- Audit identified that 8 engagements of consultants and contractors with individual contract values exceeding $50 000, having an aggregate estimated cost of $5.8 million (actual cost of $4.9 million), were made by the Department not using public tender processes but by using selective tendering or direct appointment processes.

Paras 3.8.44

Sale of Aluminium Smelters of Victoria Pty Ltd

- The net loss to the State from the sale of Aluvic was $8 million, after taking account of an amount of $109 million which was applied from the proceeds by the State to fund the closure of Aluvic's foreign exchange hedge book and to meet the State's costs of sale.

Paras 3.8.85 to 3.8.87

- In placing the overall sale result in context, it is important to recognise that the establishment by the Government in September 1997 of the supplementary power arrangements for the smelter had the impact of increasing its operating capacity which increased Aluvic's value by around $47 million.

Para. 3.8.88

- While the State has divested its interest in Aluvic, it has retained a related substantial financial exposure associated with the flexible electricity tariff arrangements which had an estimated net value of around $240 million related to its former 25 per cent interest in the Portland smelter.

Para. 3.8.89

Financial standing of WorkCover

- The proportion of the scheme's net assets in relation to its outstanding claims liability as at 31 December 1998 was 96 per cent, an improvement of 3.8 per cent from the funding ratio recorded 12 months earlier of 92.2 per cent.

Paras 3.8.128 to 3.8.135

- It is audit's view that due to the magnitude of the outstanding claims liability and the sensitivity of the scheme, the Victorian WorkCover Authority should continue to have the outstanding claims liability valued each half-year by 2 independent external actuaries and recognise the higher assessed value for accountability purposes.

Paras 3.8.136 to 3.8.144

Update on player fairness issues in the gaming industry

- The Government, in consultation with the Victorian Casino and Gaming Authority, should establish a firm timeframe for addressing important player fairness issues in the gaming industry and for the taking of action to better meet the needs of players.

Paras 3.8.145 to 3.8.171

BROAD SCOPE ISSUES Page 355

Corporate Card - follow-up

- Given the sensitivity associated with the use of Corporate Cards by government agencies, it is disappointing that, at the date of preparation of this Report, the related guidelines had not been strengthened to address the issues previously identified by audit.

Paras 4.1.1 to 4.1.6

Year 2000 issue

- The key initiatives established by the Government have provided a major focus on the Year 2000 issue and have raised Year 2000 awareness among the public and private sectors.

Paras 4.2.9 to 4.2.11

- The audit examination as at 12 April 1999 of the public sector's progress towards achieving Year 2000 readiness has concluded that a major part of the total effort required to complete Year 2000 activities was yet to be undertaken. In particular, contingency plans had not been completed for 27 per cent of total critical systems and/or processes.

Paras 4.2.12 to 4.2.53

Part 2

Parliament of Victoria

Part 2.1

Parliament of Victoria

KEY FINDING

- The audit of the financial statements of the Parliament of Victoria proved satisfactory.

PARLIAMENT OF VICTORIA

2.1.1 The audit of the Parliament of Victoria, including the Victorian Auditor-General's Office, proved satisfactory.

SCHEDULE A
COMPLETED/INCOMPLETE AUDITS

Entity	*Financial year ended*	*Reporting to Parliament*	*Financial statements signed by entity*	*Auditor-General's report signed*
COMPLETED AUDITS				
Parliament of Victoria	30 June 1998	No reporting requirements.	7 Oct. 1998	7 Oct. 1998
Victorian Auditor-General's Office *(a)*	30 June 1998	31 Oct. *Financial Management Act* 1994, s.46.	19 Aug. 1998	19 Aug. 1998

(a) The Victorian Auditor-General's Office was audited by a firm of private auditors.

Part 3

Audit of Ministerial Portfolios

Part 3.1

Education

KEY FINDINGS

Development of university IT systems - the CASMAC project

- The CASMAC project was abandoned by the participating universities mainly due to the inability of the contractor to deliver the required software according to the specifications and the contract, and logistical problems arising from the involvement of such a large number of participants in the decision-making process which proved to be detrimental in reaching consensus and achieving desired outcomes in a timely manner.

  Paras 3.1.4 to 3.1.10

- Given the magnitude of the CASMAC project which cost Victorian participating universities well in excess of $4.3 million, the failure of some Victorian universities to maintain proper records of the total costs incurred is of concern and requires attention in relation to future projects to facilitate adequate accountability.

  Paras 3.1.13 to 3.1.17

Use of computers in primary schools

- The Government has been proactive in its endeavours to provide State primary students with IT resources for learning, through increased funding and the establishment of strategies and targets to achieve specific outcomes.

  Paras 3.1.23 to 3.1.28

- While a target of one computer for every 5 students on average has been established for achievement by both primary and secondary schools by June 2000, audit identified that the current ratio was only one computer to every 9.8 primary school students in the regions surveyed by audit, with variations existing between individual schools.

  Paras 3.1.37 to 3.1.38

KEY FINDINGS *- continued*

Use of computers in primary schools *- continued*

- There remains a substantial challenge for both the Department of Education and schools in achieving their computerisation objectives and ensuring that optimum learning outcomes in this area are achieved by primary school students. In particular, there continues to be a need to ensure that the allocation of funding to schools is provided on a basis which does not disadvantage schools and students by reason of the socio-economic circumstances of school populations.

Paras 3.1.52 to 3.1.53

Utilisation of consultants and contractors by the Department of Education

- To ensure that future decisions by the Department for the engagement of consultants are made based on complete information, the full cost of the engagement should be identified in a cost-benefit analysis undertaken to support the decision.

Paras 3.1.74 to 3.1.76

- In total, approximately 40 per cent of contractors selected for audit review were not subject to competitive and public tendering.

Paras 3.1.80 to 3.1.82

- To enable proper accountability and justification of decisions to engage consultancy and contractor services, it is imperative that agencies apply the spirit of competitive selection principles. Unless alternative service providers are sought to expand the available market, the expertise will always remain with the same contractors who will continue to be appointed without competitive tendering for projects.

Paras 3.1.83 to 3.1.84

Unfunded superannuation liabilities in Victorian universities

- Qualified audit opinions were issued on the financial statements of all Victorian universities for the year ended 31 December 1998 due to the inappropriate recognition, in their balance sheets, of an asset representing the funding they expect to receive from the Commonwealth Government by way of future annual grants which in part will be applied towards their unfunded superannuation liabilities.

Paras 3.1.94 to 3.1.96

3.1.1 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.

3.1.2 Details of the specific ministerial responsibilities for public bodies within the Education sector are provided in Table 3.1A. These public bodies, together with the Department of Education, were subject to audit by the Auditor-General during 1997-98.

TABLE 3.1A
MINISTERIAL RESPONSIBILITIES FOR
PUBLIC BODIES WITHIN THE EDUCATION SECTOR

Ministerial portfolio	*Entities subject to audit*
Education	Board of Studies Telematics Course Development Fund Trust
Tertiary Education and Training	Adult, Community and Further Education Board Council of Adult Education International Fibre Centre Ltd International Training Australia Pty Ltd Post-secondary education institutions: • Universities (8) and associated companies, trusts and foundations (55) • Colleges/institutes of technical and further education (16) and associated companies (2) State Training Board Victorian Tertiary Admission Centre

3.1.3 Comment on matters of significance arising from the audit of the Department of Education and public bodies within the Education sector is provided below.

DEVELOPMENT OF UNIVERSITY IT SYSTEMS - THE UNIPOWER CASMAC PROJECT

3.1.4 To facilitate the efficient and timely development of common computing systems for application by universities across Australia, in 1991 a national initiative was established by the Australian Universities Vice-Chancellors' Committee (AVCC) to prepare a Core Australian Specification for Management and Administrative Computing (CASMAC). The project was aimed to provide universities with efficiencies in software development through the sharing of knowledge and associated costs, with the following proposed modules to be developed:

- student records;
- finance;
- physical resources;
- research and consultancy; and
- human resources.

Utilisation of computer applications.

3.1.5 In July 1993, a company known as UniPower Australia Pty Ltd (UniPower) was registered in the Australian Capital Territory by AVCC to deliver CASMAC-compliant software to the 19 participating Australian universities. The universities agreed to meet the cost, initially estimated at $11 million associated with software development and related licence fees, and to provide appropriate resources for systems specification, acceptance testing and implementation. The Victorian universities involved in this project development were:

- Ballarat University;
- La Trobe University;
- Monash University;
- RMIT University; and
- Victoria University of Technology.

3.1.6 During July 1993, UniPower entered into a contract with CHA Computer Solutions Pty Ltd (CHA) for the development of CASMAC-compliant software applications for utilisation by the participating universities. By the end of 1996, some progress had been made on several of the modules, however, as a result of repeated failures of acceptance testing of the finance application software, in February 1997 UniPower advised CHA of its intention to terminate the contract with that company. Consequently, both parties commenced legal action in the New South Wales Supreme Court in mid-1997.

3.1.7 In the May 1998 *Report on Ministerial Portfolios,* I advised that an audit review of the Victorian universities' participation in the UniPower CASMAC project would be deferred until the litigation between the 2 parties was concluded. These proceedings were finalised in July 1998, with all legal actions withdrawn and the parties agreeing to an out-of-court settlement based on a confidentiality agreement.

3.1.8 In view of these developments, I have sought to determine the reasons for the failure of the UniPower CASMAC project, to identify the costs incurred by Victorian universities in relation to this project and to provide comment on the current initiatives by Victorian universities to meet their future information technology needs.

Abandonment of CASMAC

3.1.9 The objective of CASMAC was to develop generic, adaptable and integrated core administrative computing applications which could be tailored by individual universities to meet local conditions and needs. The UniPower CASMAC project represented a collaborative effort involving 19 universities throughout Australia, to develop and implement a suite of integrated management information systems which would cater for each university's needs. **The universities advised that the key reason for the abandonment of the project was the inability of CHA to deliver the required software according to the specifications and the contract. The other contributing factor identified by audit related to logistical problems arising from the involvement of such a large number of participants in the decision-making process which proved to be detrimental in reaching consensus and achieving desired outcomes in a timely manner.**

3.1.10 **In addition, certain deficiencies in the project management and development process contributed to the abandonment of the project,** including:

- Participating universities (either individually or collectively) did not take steps to identify the risks associated with proceeding with a project of this complexity and magnitude, and therefore did not prepare action plans for managing such risks; and
- Universities did not effectively monitor the contract with UniPower at each critical stage of development. Consequently, repeated problems with service delivery by UniPower were not resolved and eventually led to the termination of the contract.

3.1.11 Notwithstanding the abandonment of the project, a number of universities advised audit that they had obtained certain benefits from their participation in the project, including:

- the CASMAC documentation provided the basis for the development of tender specifications for replacement systems;
- universities gained experience from the CASMAC application relating to research and consultancy which assisted universities in identifying more suitable packages to meet their needs;
- the utilisation by the universities of certain licences at a lower price than would have otherwise applied; and
- the professional development of universities' staff involved in the project.

3.1.12 **In February 1999, I advised UniPower of my intention to examine the CASMAC project. However, despite numerous requests for relevant information regarding this project, as at the date of preparation of this Report, the company had not responded to my Office's information request.**

Costs incurred by Victorian participating universities

3.1.13 In accordance with a 1994 Members Agreement entered into by the participating universities, all universities were required to make periodic payments to UniPower for services provided. In addition, the universities were required to make available their own resources according to assessed expertise and capacity to assist the company in the development stage of the project known as *"in-kind contributions"*. For instance, a number of universities provided facilities to assist in the development and testing of applications, which necessitated the purchase of capital equipment at the universities' expense. In addition, the Monash and La Trobe Universities incurred costs of converting data for transfer to the new system, developing interfaces to the financial system and providing staff training facilities.

3.1.14 Implicit in a project of this nature and magnitude is the need to undertake a cost-benefit analysis as an aid to determining the viability of the project. Once it is clear that sufficient benefits will accrue and a decision is taken to proceed, detailed budgets and financial management information systems should be developed to record and monitor ongoing expenditure against budgets. **However, the audit examination revealed that certain of the Victorian participating universities had not:**

- **quantified the expected benefits to be derived from the project, nor prepared a cost-benefit analysis to determine whether their participation in the project was in the best interests of the university;**
- **prepared a detailed budget to determine the likely costs of developing, implementing and maintaining the UniPower CASMAC software on an ongoing basis;**
- **developed suitable financial management systems to accurately record and monitor ongoing project expenditure; and**
- **established procedures to calculate and record the cost of providing in-house resources to UniPower.**

3.1.15 Table 3.1B provides details of the total identified costs associated with the development of the UniPower CASMAC software incurred by Victorian participating universities.

TABLE 3.1B
COSTS ASSOCIATED WITH THE DEVELOPMENT OF THE UNIPOWER CASMAC SOFTWARE BY VICTORIAN PARTICIPATING UNIVERSITIES
($'000)

Costs/contributions	*Ballarat*	*La Trobe*	*RMIT*	*Victoria*	*Monash*	*Total*
Payments to UniPower	619	1 327	846	934	1 234	**4 960**
Refund received following settlement	(92)	(159)	(126)	(138)	(173)	**(688)**
Net payments to UniPower	527	1 168	720	796	1 061	**4 272**
"In-kind contributions" (a)	(est.) 225	280	(est.) 196	*(b)*	*(b)*	

(a) Cost of providing in-house resources as advised by universities.
(b) Denotes information, while requested by audit, not provided by universities.

3.1.16 The table indicates that the net payment by Victorian universities to UniPower for work undertaken on the CASMAC project was a net amount of $4.3 million. However, this does not represent the total cost to Victorian participating universities as, in many instances, all costs associated with the development of the software were not identified and provided to audit. In particular, the cost of providing in-house resources could not be quantified by all universities. **In view of the significant resources provided by the universities for the project, audit considered that the ultimate cost attributed to CASMAC would have been far in excess of the identified costs.**

3.1.17 **It is disappointing that, given the magnitude of this project and the anticipated significant costs and resources associated with its development and implementation, all universities did not maintain appropriate financial records and monitoring systems and, consequently, were unable to accurately determine the total costs incurred on the project.**

Current initiatives of universities

3.1.18 Audit has been advised by Victorian participating universities that they are currently in the process of selecting or implementing "off-the-shelf" software packages to establish the systems that were envisaged to be covered under the CASMAC project. **The Ballarat and Monash Universities indicated that the anticipated costs of acquiring and implementing new computerised systems was around $3.5 million and $30 million, respectively. While the other Victorian participating universities were at various stages in the process of selecting and implementing new systems at the time of preparation of this Report, they had not provided audit with an estimate of the associated costs**

Overall audit assessment

3.1.19 **It is disappointing that the UniPower CASMAC project, which commenced with such high ideals and expectations, did not reach fulfilment which could have enabled Australian universities to obtain significant benefits, such as efficiencies in software development through the sharing of knowledge and the implementation of common systems enabling the more efficient and effective use of resources.**

3.1.20 **Given the magnitude of the project, the failure by some Victorian universities to maintain proper records of the total costs incurred is of concern and requires attention in relation to future projects to facilitate adequate accountability.**

3.1.21 **Finally, the abandonment of the CASMAC project has resulted in the Victorian universities having to implement new computerised systems which, in aggregate, will cost many millions of dollars in excess of the amounts originally expected to be spent on the UniPower CASMAC project.**

❒ ***RESPONSE** provided by Pro Vice-Chancellor (Resources and Development), University of Ballarat*

The University of Ballarat was disappointed with the outcome from this project. The strong commitment from staff from many universities and from Unipower towards the project should be noted. Considerable effort was directed towards developing and monitoring progress of the software. Unipower kept a comprehensive database logging issues raised by project teams on all software delivered by CHA. It is acknowledged that all attempts to achieve a satisfactory result failed.

Projected expenditure budgets were prepared by Unipower for universities and at the University of Ballarat spreadsheets were developed to regularly monitor the contribution. A paper was prepared for the Resources Board on in-kind contributions made by this University. A copy of this report was provided to your Office.

In relation to the Table of Costs it does not allow a deduction for the provision of COGNOS licences which were included as part of the agreement with Unipower. This University required the COGNOS licence to run its programs over the life of the Unipower project. It is estimated that this cost was $60 000 per year over 5 years, a total value of $300 000.

❒ ***RESPONSE** provided by Vice-Chancellor, La Trobe University*

The objective set for CASMAC was achieved. A generic set of administrative computing specifications for Australian universities was established and became the basis for the collaborative effort of some 30+ universities. There were 19 universities involved in UniPower and 11 in UniOn.

Furthermore, it is difficult to accept the notion of the "other contributing factor". There certainly were many discussions involved in reaching consensus on key issues but there were none on which agreement was not reached. In any case, it would be unreasonable to conclude that any difficulties resulted from contending views put by the Victorian universities group. The Victorian universities' representatives were, on most occasions, critically active in securing agreement on major issues.

In the section "Costs incurred by Victorian participating universities" reference is made to those incurred particularly by La Trobe University and Monash University. Certainly, both universities did incur these; some, specifically the training costs, were recouped from the UniPower budget. The other costs would have been incurred whether UniPower proceeded or some other process was put in place to update existing systems.

It cannot be refuted that all of the UniPower member universities needed (or would need) to upgrade some or all of the existing computer-based administrative systems. The compelling argument in the early '90s was that the collaborative development of a single set of such systems was likely to be less costly (if this could be achieved) than each of 19 universities going alone. This was acknowledged by DETYA (then DEET) in providing some $2 million for the project.

A detailed budget was developed by UniPower on behalf of its members; the performance against budget was monitored by the Board of Directors and by all of the member universities individually. In addition, the forward estimates for a further 3 years were provided to member universities each year.

❒ ***RESPONSE*** *provided by Vice-Chancellor, La Trobe University - continued*

The cost of the UniPower (not CASMAC) project in its ultimate form would have been more than $11 million across the 19 participants because it was anticipated that the maintenance of the developed software would be an ongoing obligation. The cost to the Victorian universities would have been more than $4.3 million for the same reason. The cost of securing the same collection of system modules on an individual basis would have been far more; perhaps based on costs, prices then in vogue (early 1990s) the total development across the 5 Victorian universities could have been as high as $40m, exclusive of ongoing maintenance.

It is disappointing that the UniPower project did not reach fulfilment but the failure of the software developers to deliver is the reason for the "additional costs" that will now be incurred. All universities whether here or elsewhere were facing the need to develop some new systems.

❒ ***RESPONSE*** *provided by Monash University*

No response provided.

❒ ***RESPONSE*** *provided by Deputy Vice-Chancellor (Resources) RMIT University*

The report focuses solely on the negative aspects of the outcomes of the project and does not adequately reflect the fact that the UniPower initiative was a national project managed and controlled by UniPower Australia Pty Ltd.

CASMAC expenditure at RMIT in relation to the internal allocation of $196 000 was tracked according to standard University financial procedures. Specific accounts to track CASMAC-related expenses were not established.

As pointed out in the Report there were a number of benefits that the University obtained from participating in the project. These included the following:

- *the CASMAC documentation provided the basis for the University's tender for the Human Resources, Finance and Fixed Assets System, (SAP System) and for the Student Management System tender;*
- *the University gained experience from the CASMAC Research and Consultancy Application which assisted it in identifying a more suitable package.*
- *The Cognos licences which were able to be purchased through UniPower at a lower price than otherwise would have applied; and*
- *the professional development of RMIT staff involved in the project.*

I would also like to point out that the costs of the new systems are not for the same product with the same features as envisioned in the CASMAC project. The systems being implemented now are more sophisticated with far greater functionality then would have been delivered under CASMAC.

❒ ***RESPONSE*** *provided by the Acting Vice-Chancellor and President of Victoria University*

Victoria University supports the view that the key reason for the abandonment of the project was the inability of CHA to deliver the required software according to the specifications and the contract.

USE OF COMPUTERS IN PRIMARY SCHOOLS

3.1.22 Revolutionary advances in information technology (IT) in the latter part of the twentieth century and the presence of computers in many facets of daily life have impacted significantly on our society. These developments represent a major challenge to governments and educational institutions in their endeavours to prepare students for the complexities of the future. Employment prospects are heavily dependent on computer skills and it is vital that students have equal opportunity in obtaining those skills.

3.1.23 **In recognition of the importance of computer education in Victorian schools, the Government has instigated a number of initiatives, including a commitment to spend $100 million over a 5 year period for the provision of laptop computers to all of the State's teachers and to achieve a computer-to-student ratio of 1 to 5 across all primary and secondary schools by the year 2000.** To assist in meeting these targets, $51.4 million in funding was committed in the 1998-99 State budget to provide Victorian schools with access to computers, the internet, on-line curriculum materials, technology training for teachers and new systems for school administration. In addition, an extra $17.2 million has been allocated in the 1999-2000 budget to provide IT technical support to schools.

Computer education and skills development
is now an important initiative in Victorian primary schools.

3.1.24 Based on the 1998 school year, the Department of Education provides administrative services to 1 250 primary schools and employs around 18 300 teachers educating approximately 300 000 students. For administrative purposes, the State primary schools are divided into 9 geographical regions by the Department.

3.1.25 Given the significance of computerisation in the educational context, audit conducted a review of the availability and utilisation of computer resources dedicated to student education in State primary schools. The scope of the review included a survey of a representative sample of 150 primary schools, of which 120 schools provided responses, and account for 13 per cent of State primary students, stratified by region and school size covering primary schools located in 4 metropolitan and 2 rural areas of Victoria.

Departmental computer policies and initiatives

3.1.26 In February 1998, the Minister for Education published the Statement, *Learning Technologies in Victorian Schools 1998-2001,* which established the following overriding goal for computer education within primary and secondary schools in Victoria:

"*For all schools by 2001 to have implemented a learning technologies plan that results in principals, teachers and students:*

- *having access to computers, a range of applications and curriculum products and on-line information and communication as a routine part of the school's education and operational program;*
- *being regular, competent and discriminating users of learning technologies in the daily program of the school;*
- *developing skills in the use of a range of technology tools; and*
- *showing leadership and innovation in the use of learning technologies*".

3.1.27 The Statement also details the overall computer education objectives and provides a strategic framework for schools to follow to achieve the desired outcomes by the year 2001. Essential features of the Statement include the need to:

- deliver appropriate computer applications to all schools irrespective of location;
- focus on efforts to achieve a more appropriate ratio of computers to students across the whole State by the year 2000;
- progressively increase teacher access to multimedia-capable computers accompanied by timely and appropriate training; and
- ensure that teachers are capable and confident in their use of new learning technologies to enhance student outcomes and manage their professional workload.

3.1.28 To facilitate the achievement of these objectives, the Department has introduced a number of initiatives, including:

- Substantial increase in IT funding over the next 5 years, including $100 million to supply all teachers with laptops and the provision of subsidies, totalling $16 million over the next 2 years, on the basis of $1 for each $3 contributed by each school to purchase specified IT facilities for both curriculum and administrative purposes;
- Establishment of computer communication facilities, such as:
    - SOFNet, which delivers 2 channels of television for all primary and secondary schools;

- SOFWeb, a web site which facilitates communication among students, teachers, parents and schools, and is designed to support student learning and teacher professional development; and
- VicOne, a core telecommunications network which links all Victorian government schools to other government communication facilities;

- Statewide licensing of products and software;
- Establishment of the Educational Channel within the Department, to provide a platform for the delivery of multimedia curriculum resources to schools;
- Professional development programs for teachers ranging from basic to advanced computer skills, use of the internet, SOFNet and SOFWeb;
- Implementation of the "Navigator Schools" project in October 1995, a pilot project involving 4 primary and 3 secondary schools. The project was designed to develop accessible working models of educational environments, incorporating learning technologies, with expertise gained to be shared with other interested schools. To implement the project, the primary schools involved in the pilot project were provided with additional funding of $3.1 million for the purchase of IT facilities; and
- Supply of 4 700 computers, obtained from a number of sources within the public and private sectors, to over 1 000 schools under the Surplus Computer Program.

3.1.29 As mentioned previously, the Government provides a subsidy of $1 for every $3 raised by school communities to fund IT facilities. However, many schools in disadvantaged socio-economic circumstances have limited capacity to raise funds from local sources and may be unable to maximise the benefit of the subsidy. By way of contrast, schools in regions which have significant local resources and are able to maximise community contributions will benefit substantially. Audit notes that the structure of schools' global budgets takes account of the socio-economic circumstances of school populations. **There is a continuing need for the Department to ensure that, in the continuation of its IT equipment subsidy program, students are not disadvantaged by reason of the socio-economic circumstances of school populations.**

Completion of Learning Technologies Implementation Plans

3.1.30 In accordance with the objectives contained in the Government's *Leaning Technologies in Victorian Schools 1998-2001* Statement, schools were required by the end of the 1998 calendar year to have completed a learning technologies implementation plan, incorporating a financial budget.

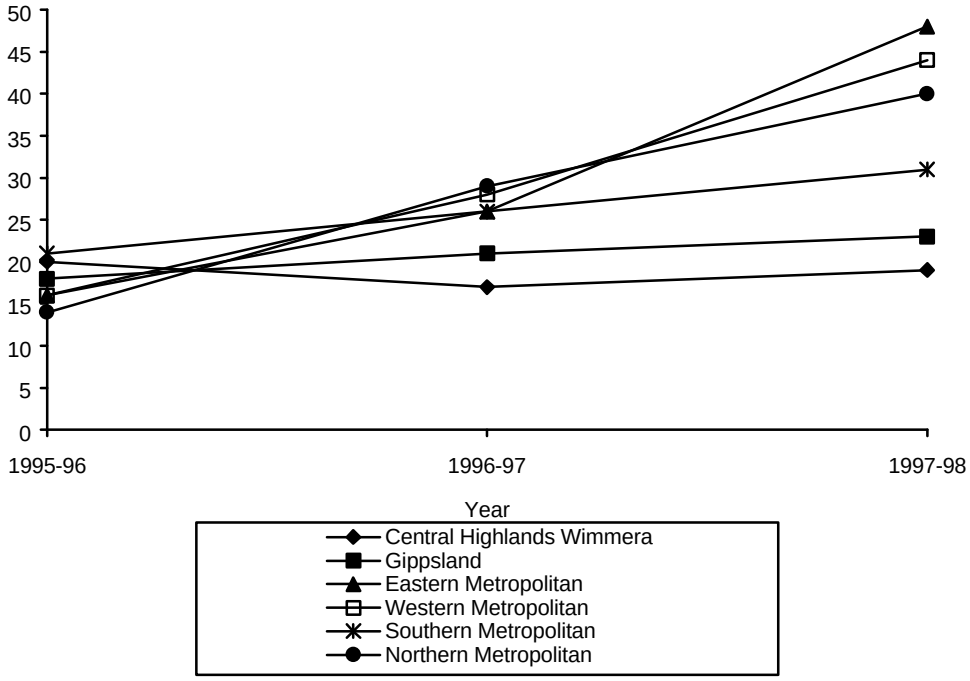
3.1.31 The Department advised that, as at March 1999, 3 of the 9 departmental regions had not provided data regarding the number of schools who had finalised their plans. However, of the remaining 6 regions, a total of 941 schools which represented around 80 per cent of primary and secondary schools in those regions had completed their plans. The Department also advised that those schools that had not developed their plans were being provided with additional assistance from relevant departmental staff to complete the task.

Trends in IT expenditure

3.1.32 The audit survey revealed that **expenditure on IT services** (including hardware, software and teacher training) **per school has increased from an average of $17 000 in 1995-96 to $34 000 in 1997-98, representing on average an increase of around 40 per cent per year.**

3.1.33 Chart 3.1C outlines the average annual IT expenditure for primary schools within 6 of the departmental regions for the period from 1995-96 to 1997-98, based on the responses received from the selected regions covered by the audit survey.

CHART 3.1C
AVERAGE ANNUAL IT EXPENDITURE PER SCHOOL, BY DEPARTMENTAL REGION, 1995-96 TO 1997-98
($'000)



3.1.34 **The chart indicates that, in 1995-96, schools within all regions expended relatively similar amounts on IT. However, by 1997-98, significant differences in amounts spent were apparent**. For example, the average expenditure per school in the Eastern Metropolitan region in 1995-96 was $16 000 and by 1997-98 had increased to $48 000. This can be contrasted with the Central Highlands Wimmera region which experienced a decrease in IT expenditure from an average of $20 000 per school in 1995-96 to $18 500 in 1997-98. On a per student basis, primary schools in the Central Highlands Wimmera region spent on average $136 per student in 1997-98, while schools in Eastern Metropolitan region spent on average $149 per student in the same period.

3.1.35 In addition, annual expenditure has remained relatively stable in rural regions during the past 3 years, in contrast to the metropolitan regions which have experienced increases of up to 300 per cent during the same period.

3.1.36 **The relatively lower levels of expenditure of schools in country regions could be a reflection of the generally smaller size of country primary schools, which enables them to spend less in total to achieve similar student to computer ratios to metropolitan schools. It could also be, in part, a reflection of the difficulties experienced by schools in rural regions in raising funds from local communities.**

Sufficiency of facilities available to students

3.1.37 **In the departmental regions surveyed by audit, the analysis indicated that, on average, there were 9.8 students per available computer**, which compared with a Statewide ratio of 8.4 primary school students per available computer reported by the Department in its *1997-98 Annual Report*.

3.1.38 **The target of students to available computer set by the Government for both primary and secondary schools is 5 to 1 by June 2000. In light of the results of the survey and the short time remaining before the year 2000, it would appear that additional resources may need to be made available to schools by the Government within a short time to achieve this target. In this regard, the Department advised that at the current rate of expenditure, the ratio of students to computers in primary schools will be 5.6 to 1 by June 2000.**

3.1.39 Comment follows on certain other issues associated with the currently available computer facilities, which were highlighted in the responses provided by primary schools to the audit survey.

Age of computers

3.1.40 The audit survey indicated that 85 per cent of computers used by students were around 2 years old with 15 per cent of computers being at least 4 years old.

Access to external communication links

3.1.41 The internet represents a valuable learning resource for schools as it provides access to information on a vast range of subjects and facilitates worldwide communication. **Audit found that at the date of the audit survey around 78 per cent of primary schools surveyed used an internet connection for educational purposes.** The majority of schools that had not yet made the internet available for educational purposes consisted of the smaller rural schools. To address this position, the Government has recently announced that all government school students will have their own internet and e-mail accounts and personal homepage on the web.

3.1.42 VICOne provides schools with access to the Victorian *whole-of-government* wide-area-network. All Victorian government schools are now connected to this facility, with 66 per cent of the schools responding to the survey indicating that they currently use VICOne for student teaching purposes.

Availability of CD-ROM facilities

3.1.43 CD-ROM enables students to have access to the latest software and multimedia facilities. The survey indicated that, with the exception of Western Metropolitan region, all other regions had a high percentage of computers equipped with CD-ROM. The Central Highlands Wimmera region had the highest ratio of availability (95 per cent), while the Western Metropolitan region had the lowest ratio of availability (68 per cent).

Departmental assistance available to schools

3.1.44 The Information Technology Division of the Department provides a range of technical support services to State primary schools including:

- "help desk" arrangements;
- programs to assist schools to procure IT facilities;
- standard agreements for IT products and services; and
- information technology planning and implementation guides.

3.1.45 **The audit survey indicated that 25 per cent of schools have taken advantage of the technical support services provided by the Department. Local assistance was often not available in rural regions and, therefore, there was an increased dependency by these regions on the services provided by the Department for assistance.**

3.1.46 **As previously mentioned, $17.2 million has been provided in the 1999-2000 budget for IT technical support to schools.**

Teacher training

3.1.47 The audit survey revealed that 86 per cent of State primary schools had formal IT training programs in place to enhance teachers' computer skills. In addition, the survey highlighted that 94 per cent of teachers consider that they possess basic computer skills, however, **the majority of schools indicated that generally teachers' knowledge of IT was still inadequate and more funds and teachers' time devoted to IT training would be desirable. Nevertheless, this was considered difficult, given limits on the school budgets and the other demands placed on teachers' time.**

3.1.48 The Department, through its Schools Programs Division and its Professional and Leadership Development Centre, provides a range of professional development courses for teachers. The courses are designed to develop and enhance the computer skills of teachers and cater for their needs and skill level. Courses offered range from 2 hours to 5 day training sessions on various subjects ranging from basic to advanced computer skills, use of the internet, SOFNet and SOFWeb. To attend these courses, participants may be required to pay fees. Some are offered free with the most expensive course being as high as $600. These costs are required to be met from the schools' current professional development allowance of $260 per annum per teacher which is provided by the Department.

3.1.49 In addition to formalised training sessions, the Department has distributed to all State primary schools *Self-Paced Computer Learning CD-ROMS* which, according to the survey is the most popular form of IT training for teachers. The audit survey also highlighted that 75 per cent of IT training expenditure was funded from government sources, as parents were reluctant to pay for the professional development of teachers.

3.1.50 **In order to ensure continuing training opportunities for teachers, the Department needs to reassess the current $260 per teacher per year professional development funding. In this regard, audit noted that the Department provides additional funds of up to 50 per cent per teacher per year to assist teachers in small rural schools.**

Overall audit assessment

3.1.51 **The audit review found that the Government has been proactive in its endeavours to provide State primary students with IT resources for learning, through increased funding and the establishment of strategies and targets to achieve the specific outcomes.**

3.1.52 **While a target of one computer for every 5 students on average has been established for achievement by primary and secondary schools by June 2000, the audit identified that the current ratio was only one computer to every 9.8 primary school students in the regions surveyed by audit, with variations existing between individual schools.**

3.1.53 **There remains a substantial challenge for both the Department and schools in achieving their computerisation objectives and in particular ensuring that optimum learning outcomes in this area are achieved by primary school students. In particular, there is a continuing need to ensure that the allocation of funding to schools is provided on a basis which does not disadvantage schools and students by reason of the socio-economic circumstances of school populations.**

3.1.54 **It is pleasing to note that since the commencement of the audit review, the Government has announced 3 further strategies which will assist the Department in providing high quality computer education to Victorian State primary and secondary school students. The 3 strategies announced were:**

- **an additional $10.4 million to purchase new computers;**
- **$17.2 million has been allocated in the 1999-2000 budget to provide IT technical support to schools; and**
- **all Victorian State school students will obtain their own e-mail address and personal home page on the web.**

❒ ***RESPONSE*** *provided by Secretary, Department of Education*

Departmental computer policies and initiatives

The Report provides no data that allows it to conclude that "many schools in disadvantaged socio-economic circumstances ... may be unable to maximise the benefit of the subsidy". The Department has in place, and will continue, its policy of ensuring that school funding arrangements, including those related to the provision of computers, take into account the socio-economic and geographic contexts of individual schools. Parent contributions represent approximately 2.7 per cent of primary school disposable income, according to an independent analysis conducted by the RMIT University. The methodology used in this analysis was the same methodology used by the Auditor-General in his May 1997 Report on Ministerial Portfolios which examined financial management in schools.

Learning Technologies Implementation Plans

A Department survey completed in March 1999 indicates that 92.5 per cent of schools have now completed these plans. Regional Principal Consultants are assisting the remaining schools to finalise their plans.

Trends in IT expenditure

The trends reflected in Chart 3.1C reflect the fact that schools in metropolitan regions are, on average, larger and therefore spend more per school on information technology. Reduced expenditure reported in the Central Highlands region between 1995-96 and 1997-98 is likely to reflect the transfer of all costs for Microsoft and anti-virus software from schools to the Department and an, on average, 15 per cent reduction in technology costs as a result of Statewide contracts.

There is no evidence to suggest that students currently suffer disadvantage in relation to computer provision by reason of their geographical location. On the contrary, the average per student subsidy provided to non-metropolitan schools to June 1998 was $51 and to metropolitan schools was $45.

Between 31 December 1996 and 31 December 1998, the total funds held in primary schools bank accounts increased form $110 million to in excess of $130 million. In country regions, total funds held in primary school bank accounts increased from $43 million to $49 million during this period, representing an increase of approximately $58 per student in country schools. This increase is inconsistent with any suggestion that smaller schools had difficulty raising funds to take advantage of the subsidy program.

Sufficiency of facilities available to students

At the current rate of expenditure, the Department is confident of achieving its target of a computer to student ratio of 1:5 across all schools by June 2000. Subsidies now available to schools are estimated to deliver an additional 24 050 computers to schools before June 2000, more than enough to meet the target. The ratio as at May 1999 is 1:6.5.

Access to external communication links

The Department's survey of internet connections indicated that at December 1997, 92 per cent of all schools were connected to the internet. A copy of the survey report was provided to the Auditor-General.

❒ ***RESPONSE*** *provided by Secretary, Department of Education - continued*

Department assistance available to schools

An additional $104 million over 4 years for specialist and technical support to schools has been provided in the 1999-2000 Victorian budget.

Teacher training

Between 1996 and 1998 in excess of 20 000 teachers have participated in professional development courses provided by the Department concerning the use of Information Technology in the classroom.

In addition to extensive in-school and out of school teacher training programs, the Department has provided 12 158 notebook computers rising to 15 000 by October 1999 for teachers to support enhanced teacher IT skills.

UTILISATION OF CONSULTANTS AND CONTRACTORS BY DEPARTMENT OF EDUCATION

3.1.55 Over recent years, the Government has implemented significant reforms within the public sector, broadly aimed at improving the efficiency and effectiveness of service delivery and the overall financial performance of the State. The Auditor-General's May 1996 *Report on Ministerial Portfolios* outlined the results of an audit review that focused on the utilisation of consultants within the public sector, which has played a pivotal role in the reform process. Specifically, the review found that the extent of expenditure incurred on consultancy services could not be reliably determined as ambiguity existed as to the definition and classification of consultancy and contractor services by agencies.

3.1.56 As a result of that audit review, the Government commenced action to clarify the distinction between "consultancy" and "contractor" services in order to assist public sector agencies in the interpretation of the definition, and to enhance the usefulness of information provided by agencies for annual reporting purposes as to the extent of utilisation of consultancies.

3.1.57 In reporting on consultants, departments were guided by the definition and examples issued by the Victorian Government Purchasing Board and incorporated into its *Supply Policies and Guidelines Manual*. Within the manual, a consultancy is defined as an arrangement where an individual or organisation is engaged:

- to provide expert *analysis* and *advice* which facilitates decision-making;
- to perform a *specific, one-off task* or set of tasks; and
- to perform a task involving skills or perspective which would not normally be expected to reside within the agency.

3.1.58 However, an arrangement with a contractor is considered to have the following attributes:

- to provide goods, works or services which implement a decision;
- to perform all or part of a new or existing ongoing function to assist an agency to carry out its defined activities and operational functions; and
- to perform a function involving skills or perspectives which would normally be expected to reside within the agency but which the agency has determined to outsource.

3.1.59 Under the guidelines, for an engagement to be classified as a "consultancy", it is required to meet all of the above relevant criteria, otherwise the engagement is deemed a "contractor".

3.1.60 Notwithstanding the action undertaken by the Government to clarify consultant and contractor services, audit considers, and has been advised by both the Victorian Government Purchasing Board and the Department of Education, that confusion still existed in the interpretation of what constitutes consultancy as against contractor services, which caused uncertainty as to the extent of utilisation of consultancies.

3.1.61 **To ensure the proper classification of consultancy and contractor services by agencies for annual reporting purposes, consideration needs to be given by the Victorian Government Purchasing Board to the further clarification of the definitions contained within its guidelines.**

3.1.62 **The Auditor-General's October 1998 *Report on the Victorian Government's Finances, 1997-98* further recommended that as a consequence of the increasing trend within the public sector for service delivery through contractor services and outsourcing arrangements, and the increasing impact of such services on agency financial operations, it was important that appropriate annual reporting requirements be introduced in relation to such services to enhance transparency and disclosure to Parliament of the total cost of contractors and outsourced activities engaged by Government Departments.**

3.1.63 This Report outlines the results of an audit review of the procedures followed by the Department of Education for the appointment of consultants and contractors to determine the extent to which the Department has complied with the Government's supply policies and guidelines.

Purchasing framework

3.1.64 The Victorian Government Purchasing Board was established under the *Financial Management Act* 1994 and replaced the State Tender Board from 1 February 1995. A key function of the Purchasing Board is to develop, implement and review supply policies and practices. These supply policies and practices form part of the Ministerial Directions issued under the authority of the *Financial Management Act* 1994.

3.1.65 In the 1995-96 financial year, the Purchasing Board devolved certain of its purchasing functions to government departments through an accreditation process. In addition, individual departments have been allocated the responsibility for accountability in relation to procurement activities.

3.1.66 The Department of Education established an Accredited Purchasing Unit which provides a focus for the co-ordination and management of purchasing activity across all agencies within the portfolio. In August 1995, the Department was permitted to approve purchases with a value up to $500 000 without further reference to the Purchasing Board. This limit was increased to $1 million in November 1998. **The audit review disclosed that the Department's purchasing guidelines were in agreement with those issued by the Purchasing Board.**

3.1.67 A key mechanism established by the Purchasing Board to monitor compliance by public sector agencies with the government supply policies is the requirement that all agencies furnish an *Annual Compliance Report* to the Board. In turn, the Purchasing Board produces a *Report on the Condition of Government Procurement in Victoria*, which assesses and summarises the results of all agencies data for the year ended 30 June, which is then presented to Parliament in October of each year.

3.1.68 The Purchasing Board does not have the legislative mandate to ensure that the compliance reports provided by each agency are subject to independent verification to ensure the completeness and accuracy of data reported to Parliament. **Accordingly, consideration should be given to the Purchasing Board establishing appropriate quality assurance procedures to ensure the reliability of the information provided to the Parliament.**

Consultants and contractors engaged by the Department

3.1.69 The Department generally engages consultants where:

- specialist expertise is not available within the Department or is not readily available within the time constraints established for particular tasks or projects;
- the experience of private organisations or industry is necessary or highly desirable in formulating a policy or program within the Department; and
- the nature of the project is such that the impartiality of an external consultant is essential to a successful outcome.

3.1.70 The Department maintains a Purchasing Manual which encompasses all supply policies and procedures to guide its personnel in all stages of the supply function for goods and services.

3.1.71 The audit examination identified that, during the 3 year period ended 30 June 1998, the Department had incurred expenditure of around $9.4 million on the engagement of consultants. Table 3.1D illustrates this position.

TABLE 3.1D
UTILISATION OF CONSULTANTS,
1995-96 TO 1997-98

Financial year	*Engagements (a)*	*Total cost (b)*
	(no.)	*($m)*
1995-96 *(c)*	293	4.7
1996-97	72	2.5
1997-98	84	2.2
Total	**449**	**9.4**

(a) Represents the number of consultants engaged by Department of Education, State Training Board, Board of Studies and Adult, Community and Further Education Board.

(b) The total cost of consultancies.

(c) The Department has advised audit that the decrease in the number of consultants between 1995-96 and later years is due to the clarification of the definition of a consultant plus changes in the way services are undertaken within the Department.

Source: Figures in table extracted from Department of Education Annual Reports.

3.1.72 Audit was unable to determine the expenditure incurred over this period for contractor services as the Department's financial system did not readily identify this information. Nevertheless, a sample of consultancy and contractor engagements was selected and examined by audit to determine whether the Department has complied with the Victorian Government Purchasing Board's and the Department's supply policies and guidelines.

3.1.73 **Audit found that the selected consultancies and contractors were generally engaged and administered by the Department in accordance with the guidelines issued by the Victorian Government Purchasing Board and the Department. However, the review also identified a number of deficiencies which will require corrective action by the Department.** Comments on the deficiencies identified by audit follow.

Cost-benefit analysis not based on full cost of engagement

3.1.74 The Department's supply guidelines state that prior to undertaking a consultancy project, it needs to determine and document the benefits anticipated from the engagement of the consultant. For major consultancies, a detailed cost-benefit analysis should be conducted prior to the project proceeding. The full cost of a consultancy should include the use of departmental facilities, administration, in-house staff required to assist or manage the consultancy project, and direct consultant costs.

3.1.75 The audit review revealed that in one instance, a decision to undertake a consultancy project was made only on the basis of the fee payable to the consultant, rather than the full cost of the project.

3.1.76 **To ensure that future engagement decisions are made based on complete information, the full cost of the engagement of major consultancies should be identified in a cost-benefit analysis undertaken to support the decision.**

Conflicts of interest not identified

3.1.77 Prior to engaging consultants, management is required to be alert to the types of conflicts of interest that can exist and ensure they are minimised. The Purchasing Board's *Supply Policies and Guidelines* indicate that departments should request consultants to provide a written assurance that there is no current or potential conflict of interest created as a result of their engagement on a consultancy project.

3.1.78 The audit review identified that, in most instances, contracts entered into with the consultants included a conflict of interest clause. However, there was no evidence that the Department had requested details of current or potential conflicts of interest where consultants were engaged by an exchange of letters.

3.1.79 **The Department needs to enhance its pre-engagement practices to ensure that any current and potential conflicts of interest situations are identified and assessed.**

Non-application of competitive tendering processes

3.1.80 Under the guidelines, the procurement of consultancy and contractor services should follow competitive selection procedures to enable proper accountability and the justification of the decision to engage a particular consultant. Competitive quotations or tendering must be used for engaging consultants, unless there are exceptional circumstances, in which case the Secretary's approval must be obtained to authorise the alternative approach. However, variations may occur under the following circumstances:

- if the amount to be expended is estimated to exceed $100 000, tenders must be invited publicly unless it is certified by the accountable officer that it is not practical and expedient to do so; and
- where tenders are not invited publicly, at least 3 written quotations must be obtained unless it is further certified by the accountable officer that it is not practical or expedient to do so.

3.1.81 Reasons for not proceeding with public tender include confidentiality, strict timelines, specialised expertise, and where a consultant has previously undertaken an integral or related project.

3.1.82 Although a large number of consultants selected for audit review were not subject to competitive and public tendering, the justification and authorisation for proceeding to obtain written quotations and calling for public tendering was documented on departmental files. **In total, approximately 40 per cent of contractors selected for review were not subject to competitive and public tendering.**

3.1.83 Examples identified by audit where consultants were engaged without undergoing a competitive tendering process included the engagement of 2 companies by the Department which were successful in gaining 14 contracts between April 1994 to June 1998, with a cumulative value in excess of $540 000 without ever being subjected to competitive quotes and tender. The consultant was directly appointed by the Department without calling for tenders or quotes mainly on the grounds of the consultant's expertise in the required tasks to be performed, although the nature of the projects did vary from contract to contract.

3.1.84 **To enable proper accountability and justification of decisions to engage consultancy and contractor services, it is imperative that agencies apply the spirit of competitive selection principles. Unless alternative service providers are sought to expand the available market, the expertise will always remain with the same contractors who will continue to be appointed without competitive tendering for projects.**

Inadequate approval to engage consultants

3.1.85 The Department's guidelines for engaging consultants requires that an approval needs to be provided by the Secretary of the Department or a nominated delegate prior to engaging consultants.

3.1.86 However, the audit review of a number of consultancy contracts entered into by the Department during the 1997-98 financial year indicated that 26 per cent of the consultancy contracts examined totalling $252 000 commenced prior to the required approval being obtained. In one case, the Secretary's approval was not sought until after the expiry of the term of the contract.

3.1.87 **The Department should ensure that the supply policy and procedures are complied with at all times and, in particular, that the required approvals are obtained prior to the engagement of consultants and contractors.**

❒ ***RESPONSE*** *provided by Chairperson, Government Purchasing Board*

No response given.

❒ ***RESPONSE*** *provided by Secretary, Department of Education*

Cost-benefit analysis not based on full cost of engagement

The Department's purchasing manual recently reissued (March 1999) specifically requires that a financial analysis (cost and benefit analysis) be undertaken and outlines critical issues for consideration. The Accredited Purchasing Unit will reiterate this principle again in a forthcoming Purchasing Bulletin.

Conflicts of interest not identified

The Department has already addressed this issue through amendments to the standard letter of engagement for consultants, to include an appropriate conflict of interest clause.

Non-application of competitive tendering processes

The Department recognises that some consultancies were not subject to competitive tendering although the Report acknowledges that justification and authorisation was documented on departmental files.

It must be recognised that at times services required are of a specialised nature and therefore it is not considered value-for-money nor practicable to seek quotations or tenders for these services.

The Accredited Purchasing Manual provides a process for identifying consultancies which are not subject to external tender including documentation of reasons for not proceeding with tender. The accountability for obtaining the best consultancy for the Department rests with individual managers subject to compliance with the Department's procedures.

Inadequate approval to engage consultants

The Chairperson of the Accredited Purchasing Unit has reiterated this requirement in a memorandum to all departmental Deputy Secretaries and other senior officers and a Purchasing Bulletin on this issue will be circulated shortly to all staff.

UNFUNDED SUPERANNUATION LIABILITIES IN VICTORIAN UNIVERSITIES

3.1.88 Victorian universities, as employers, over many years have accumulated unfunded superannuation liabilities with the State Superannuation Fund in respect of services provided by their employees. These liabilities were not recognised in university balance sheets in previous years, given that the Department of Treasury and Finance issued an accounting direction under the authority of the *Financial Management Act* 1994 requiring these liabilities to be reported (in effect, assumed) by that Department. However, the accounting direction was recently amended in January 1999 now requiring the universities to report the unfunded liabilities for the year ended 31 December 1998.

3.1.89 All universities receive annual recurrent grants from the Commonwealth Government under the *States Grants (General Purposes) Act* 1994 to assist in the financing of their operations. These grants are annually determined by the responsible Commonwealth Minister and are paid to universities by way of special parliamentary appropriations. The grants are intended to provide general assistance towards meeting operating costs such as salaries, long service leave, general expenditure etc., including the emerging costs of superannuation. Under the *Higher Education Funding Act* 1988, the responsible Commonwealth Minister may also provide additional grants to universities to meet additional emerging costs of superannuation above those funded under the *States Grants (General Purposes) Act* 1994.

3.1.90 All the Victorian universities have complied with the Ministerial direction to report the unfunded superannuation liability in their financial statement for the year ended 31 December 1998. Details of these liabilities are shown in Table 3.1E below:

TABLE 3.1E
UNIVERSITIES' UNFUNDED SUPERANNUATION LIABILITIES, 31 DECEMBER 1998
($million)

Entity	*Unfunded superannuation liability*
Royal Melbourne Institute of Technology	220.5
Deakin University	137.6
Monash University	111.6
Swinburne University of Technology	96.8
University of Melbourne	74.3
Victorian University of Technology	69.9
La Trobe University	48.5
University of Ballarat	46.7
Victorian College of the Arts (controlled entity of the University of Melbourne)	11.9
Total	**817.8**

3.1.91 While the universities have reported their unfunded superannuation liabilities in their balance sheets, they have also recognised an equivalent amount as an asset representing the funding they expect to receive from the Commonwealth Government by way of future annual grants to meet these liabilities. This accounting treatment was supported by the Victorian Department of Treasury and Finance.

3.1.92 In early May 1999, I advised the Minister for Finance that, in my opinion, as the universities did not exercise control over the future Commonwealth Government funding associated with the unfunded superannuation liabilities, a right to these funds should not have been recognised as an asset in the universities' balance sheets.

3.1.93 The Minister for Finance responded to the issue by writing to the universities, indicating his support for the accounting treatment adopted by the universities and inviting them to insert the following *Response to the Auditor-General's Qualification* in their annual reports.

MINISTER FOR FINANCE
MINISTER FOR GAMING

Response to the Auditor-General's Qualification

Dear Reader

The Auditor-General has resolved to qualify the University's financial report on the grounds that he is unable to confirm, as an asset, the receivable from the Commonwealth Government to cover the costs associated with the unfunded superannuation liability.

In my view, while the approach taken by the Auditor-General may be justified in technical terms, it fails to recognise the actual relationships involved and to that extent, is quite misleading. The Commonwealth Government has provided funds for the unfunded superannuation liabilities of universities since funding responsibility for higher education transferred to the Commonwealth 25 years ago. Further, guidelines issued by the Commonwealth require universities to recognise as an the asset the Commonwealth's commitment to meet unfunded superannuation costs. The Victorian Government Solicitor's Office confirms that it is reasonable for universities to recognise a legal supportable claim on the Commonwealth for the funding of unfunded superannuation liabilities. On the basis of these facts, the Department of Treasury and Finance has advised that the receivable from the Commonwealth qualifies as an asset as defined in Statement of Accounting Concepts (SAC 4) *Definition and Recognition of the Elements of Financial Statements.*

For these reasons, I believe the approach taken by the Auditor-General misrepresents the financial position of the University. Failure to recognise the receivable from the Commonwealth suggests that the University will need to fund its unfunded superannuation liability from its balance sheet. This, however, bears no relationship with the financial reality that the Commonwealth is committed to meet these costs and that obligation reflects a long-standing agreement between the State of Victoria and the Commonwealth.

I note also that universities in both New South Wales and South Australia recognise a receivable from the Commonwealth for the ongoing costs of meeting their unfunded superannuation liabilities and that this treatment does not attract audit qualifications in those jurisdictions.

I am disappointed that this matter could not be resolved this financial year and I commend the University for its patience and diligence in seeking to resolve this matter.

Yours sincerely
(signed)

ROGER M HALLAM MLC
Minister for Finance
Minister for Gaming

3.1.94 I remain of the view that in the context of the current professional accounting framework in Australia and the arrangements between the Commonwealth Government and universities, it is misleading for universities to include an asset in their balance sheets equivalent to the unfunded superannuation liabilities for a number of reasons, including:

- Based on the definition of an asset in Statement of Accounting Concepts (SAC4) *Definition and Recognition of the Elements of Financial Statements,* universities do not have a recognisable asset which is controlled at balance date and the Commonwealth Government does not have a present obligation to universities as at balance date equivalent to the value of unfunded superannuation liabilities;
- The Commonwealth Government itself does not recognise a corresponding liability, a position which is agreed and accepted by the Commonwealth Auditor-General;
- Consistent with the above position, the Commonwealth Government is not willing to provide a confirmation of a present obligation to universities despite a representation from the Minister for Finance to the Commonwealth Minister for Education, Training and Youth Affairs;
- The grants provided to universities are intended to provide general financial assistance towards meeting operating costs (i.e. salaries, long service leave, general expenditure etc.) including the emerging costs of superannuation, with these grants annually determined by the responsible Commonwealth Minister and paid to universities under special parliamentary appropriations. At balance date, the universities do not control an asset equivalent to the value of the unfunded liabilities, with such control exercised only once the annual Commonwealth appropriation is provided/earned (that is, on an emerging cost basis); and
- Australian Accounting Standard AAS31 states that the "the intention of a government to make payments to other parties, whether advised in the form of a budget policy, election promise or statement of intent does not of itself create a present obligation which is binding on the government".

3.1.95 In view of the above, qualified audit opinions were issued on the financial statements of all Victorian universities for the year ended 31 December 1998.

3.1.96 **Further dialogue between universities, the Victorian Department of Treasury and Finance, and the Commonwealth Government needs to take place to ensure that the issue is resolved so that future qualifications of the universities' financial statements are avoided.**

LOSSES, THEFTS AND IRREGULARITIES

3.1.97 Table 3.1F summarises the losses, thefts and irregularities, including property damage, which occurred in 1998, and which were reported to audit by entities within the Education sector.

TABLE 3.1F
LOSSES, THEFTS AND OTHER IRREGULARITIES
($)

Item	*Amount*
Department of Education -	
Funds	21 000
Equipment and property damage	2 280 000
Technical and Further Education Institutes -	
Funds	148 500
Equipment and property damage	14 300
Universities -	
Funds	33 700

3.1.98 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 was arson and police were notified. The major fires reported and estimated damage were as follows:
  - Northland Secondary College - $600 000;
  - Olympic Village Primary School - $500 000;
  - Great Ryrie Primary School - $310 000; and
  - Robinvale Secondary College - $250 000.
- Computers and audio visual equipment to the value of $21 000 was stolen from Norwood Secondary College; and
- An amount of around $30 000 was fraudulently obtained by a former employee of RMIT University during 1997 and 1998 through improper practices associated with the University's petty cash and credit card systems. The matter has been referred to the Victorian Police for action and a claim has been lodged with the University's insurers under its fidelity guarantee cover.
- An amount in excess of $139 000 was misappropriated by an employee of the Gordon Institute of TAFE over the period 1992 to 1998. The employee was charged and the case heard before the County Court in March 1999 where the former employee was sentenced to a term of imprisonment. The employee has repaid the amount of $7 821, with the remainder of the loss, together with the costs associated with the investigation, being sought through the Institute's insurer.

SCHEDULE A
STATUS OF MATTERS RAISED IN PREVIOUS REPORTS

Report	*Subject*	*Status at date of preparation of this Report*
	MATTERS RESOLVED OR ACTION COMMENCED	
DEPARTMENT OF EDUCATION		
Ministerial Portfolios, May 1998, pp.19-30.	Recent assessments of the level of maintenance booklog in schools across the State indicates the need for expenditure of $275.4 million over a 5 year period.	In 1997-98, a total of $31 million was allocated to schools to fund works identified through the Department's Physical Resource Management System (PRMS). In 1998-99, a total of $91 million has been allocated specially for PRMS works as at the date of preparation of this Report. During 1997-98 and 1998-99 a number of construction and upgrade projects have been approved, which will also address any maintenance requirements that have been identified through PRMS for those buildings that are being upgraded.
SWINBURNE UNIVERSITY OF TECHNOLOGY		
Ministerial Portfolios, May 1998, pp. 31-7.	Swinburne University's car park and student residence complex on its Hawthorn Campus, which was completed in late 1996, has experienced significantly lower operating surplus than originally projected.	The University has advised that during 1998 occupancy levels for both the car park and student residences have stabilised to favourable levels. For most of that year, actual revenues were in accordance with projections, although some additional expenditures were experienced, which resulted in a slightly lower operating surplus. The lease with the former car park operator was terminated in November 1998, due to the firm becoming insolvent. The University is currently managing these facilities and is seeking a new private sector operator.

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

Report	*Subject*	*Status at date of preparation of this Report*
	MATTERS RESOLVED OR ACTION COMMENCED - *continued*	
SWINBURNE UNIVERSITY OF TECHNOLOGY - *continued*		
Ministerial Portfolios, May 1998, pp. 31-7.	The University's Mooroolbark Campus commenced operations in 1992 and continued until 1996 when its Lilydale Campus was opened. The full financial impact of the University's decision to invest in the Mooroolbark Campus at a cost of around $5.2 million, which it only utilised for 5 years, will not be determined until the property is sold.	The Mooroolbark campus has now been leased to a private educational provider, with an option to purchase the facility at the end of the 5 year term.
ROYAL MELBOURNE INSTITUTE OF TECHNOLOGY		
Ministerial Portfolios, May 1997, pp. 33-4.	A review conducted by independent consultants during 1995 identified that $125 million of necessary expenditure on safety, regulatory and building condition works over a 10 year period was required to bring the University's building stock to an acceptable standard. However, the University's planned maintenance expenditure is substantially less than required.	The University has implemented a long-term program to address the issue. A total of $24.2 million is budgeted from 1998 to 2001 to assist in addressing some of the regulatory works identified in the consultant's report.
ADULT, COMMUNITY AND FURTHER EDUCATION BOARD		
Ministerial Portfolios, May 1997, pp. 46-7.	The Board needs to establish criteria to assess service providers' submissions and to document evaluations to ensure that funding allocations are soundly based and equitable.	The Board has implemented a Grants Management System and an associated common funding application form to be used for all funding applications. The new system provides for both quantitative and qualitative analysis to be undertaken prior to determining the funding allocations to service providers.
Ministerial Portfolios, May 1997, p. 47.	Due to deficiencies in accountability arrangements with service providers relating to the follow-up, use and audit of service provider's financial statements by regional councils, assurance was generally not obtained that grants had been appropriately expended in accordance with performance agreements.	One of the features of the Board's Grants Management System is its capacity for enhanced accountability. Regional councils are now required to obtain from service providers statistical data and financial information relating to the expenditure of grants. For larger grants, audited information is required to be provided by the service providers. The results of the accountability requirements are taken into consideration in the allocation of future grants.

SCHEDULE B
COMPLETED/INCOMPLETE AUDITS

Entity	*Financial year ended*	*Reporting to Parliament*	*Financial statements signed by entity*	*Auditor-General's report signed*
		COMPLETED AUDITS		
EDUCATION				
Board of Studies	30 June 1998	31 Oct. *Financial Management Act* 1994, s.46.	31 July 1998	13 Aug. 1998
Department of Education	30 June 1998	" "	31 Aug. 1998	31 Aug. 1998
Telematics Course Development Fund Trust	31 Dec. 1997	" "	26 Mar. 1998	30 Sept. 1998
" "	31 Dec. 1998	" "	29 Mar. 1999	6 May 1999
TERTIARY EDUCATION AND TRAINING				
Adult, Community and Further Education Board	30 June 1998	31 Oct. *Financial Management Act* 1994, s.46.	31 Aug. 1998	29 Sept. 1998
International Fibre Centre Ltd	Period 21 Apr. 1998 to 31 Dec. 1998	30 April. *Financial Management Act* 1994, s.53A.	19 Feb. 1999	24 Feb. 1999
International Training Australia Pty Ltd	31 Dec. 1998	" "	2 Mar. 1999	10 Mar. 1999
State Training Board	30 June 1998	31 Oct. *Financial Management Act* 1994, s.46.	31 Aug. 1998	25 Sept. 1998
Victorian Tertiary Admission Centre	30 June 1998	No reporting requirements.	12 Nov. 1998	13 Nov. 1998
POST-SECONDARY EDUCATION INSTITUTIONS				
Universities and associated companies				
AMPASC Pty Ltd	Period 24 July 1997 to 31 Dec. 1998	30 April. *Financial Management Act* 1994, s.53A.	4 Mar. 1999	12 Mar. 1999
Australian Alpine Institute Pty Ltd	Period 1 Nov. 1997 to 31 Dec. 1997	" "	19 Apr. 1999	22 Apr. 1999
" "	31 Dec. 1998	" "	19 Apr. 1999	22 Apr. 1999

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*				
POST-SECONDARY EDUCATION INSTITUTIONS - *continued*				
Universities and associated companies				
Australian International Health Institute Ltd	Period 9 Sept. 1998 to 31 Dec. 1998	30 April. *Financial Management Act* 1994, s.53A.	1 Apr. 1999	21 Apr. 1999
Australian Music Examination Board (Vic.) Ltd	31 Dec. 1998	" "	18 Feb. 1999	12 Apr. 1999
Australian National Academy of Music Ltd	31 Dec. 1998	" "	10 Mar. 1999	29 Mar. 1999
Centre for Innovative Enterprise Pty Ltd	31 Dec. 1998	" "	25 Feb. 1999	18 Mar. 1999
Citytech Pty Ltd	31 Dec. 1998	" "	4 May 1999	12 May 1999
Centre for Innovative Enterprise Trust	31 Dec. 1998	" "	4 Mar. 1999	22 Mar. 1999
Council of Adult Education	31 Dec. 1998	30 April. *Financial Management Act* 1994, s.46.	26 Mar. 1999	30 Mar. 1999
Deakin University *(b)*	31 Dec. 1998	" "	3 May 1999	11 May 1999 *(a)*
Deakin Software Services Pty Ltd	31 Dec. 1998	30 April. *Financial Management Act* 1994, s.53A.	3 May 1999	11 May 1999
Heximа Ltd	Period 17 July 1997 to 31 Dec. 1998	" "	26 Apr. 1999	29 Apr. 1999
Inskill Ltd	31 Dec 1998	" "	29 Mar. 1999	11 May 1999
Institute for Innovation and Enterprise Ltd	31 Dec. 1998	" "	10 Mar. 1999	18 Mar. 1999
Land and Food Services Ltd *(c)*	31 Dec. 1998	" "	25 Feb. 1999	26 Mar. 1999
La Trobe International Pty Ltd	31 Dec. 1998	" "	16 Mar. 1999	24 Mar. 1999

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*				
POST-SECONDARY EDUCATION INSTITUTIONS *- continued*				
Universities and associated companies - continued				
La Trobe Marketing Pty Ltd	31 Dec. 1998	30 April. *Financial Management Act* 1994, s.53A.	18 Mar. 1999	23 Mar. 1999
La Trobe University *(b)*	31 Dec. 1998	30 April. *Financial Management Act* 1994, s.46.	30 Apr. 1999	11 May 1999 *(a)*
La Trobe University Housing Ltd	31 Dec. 1998	30 April. *Financial Management Act* 1994, s.53A.	15 Mar. 1999	24 Mar. 1999
Meanjin Company Ltd	31 Mar. 1998	" "	1 Mar. 1999	5 Mar. 1999
" "	Period 1 Apr. 1988 to 31 Dec. 1998	" "	26 Mar. 1999	9 Apr. 1999
Melbourne Enterprises International Ltd *(d)*	31 Dec. 1998	" "	19 Mar. 1999	31 Mar. 1999
Melbourne Information Technologies Australia Pty Ltd	31 Dec. 1998	" "	9 Mar. 1999	12 Apr. 1999
Melbourne Research Enterprises Ltd	31 Dec. 1998	" "	19 Mar. 1999	1 Apr. 1999
Melbourne University Press Pty Ltd	Period 16 June 1998 to 31 Dec. 1998	" "	1 Mar. 1999	19 Apr. 1999
Melbourne University Private Ltd	Period 13 Jan. 1998 to 31 Dec. 1998	" "	1 Mar. 1999	19 Apr. 1999
Meltech Services Ltd	31 Dec. 1998	" "	9 Apr. 1999	12 Apr. 1999
Monash - Mt Eliza Graduate School of Business and Government Ltd	31 Dec. 1998	" "	15 Feb. 1999	19 Mar. 1999
Monash International Pty Ltd	31 Dec. 1998	" "	16 Feb. 1999	19 Feb. 1999

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*				
POST-SECONDARY EDUCATION INSTITUTIONS - *continued*				
Universities and associated companies - ***continued***				
Monash IVF Pathology Services Trust	31 Dec. 1998	30 April. *Financial Management Act* 1994, s.53A.	1 Feb. 1999	29 Mar. 1999
Monash IVF Pty Ltd	31 Dec. 1998	" "	1 Feb. 1999	19 Mar. 1999
Monash Language Centre Pty Ltd	31 Dec. 1998	" "	16 Jan. 1999	19 Feb. 1999
Monash Reproductive Pathology and Genetics Pty Ltd *(e)*	31 Dec. 1998	" "	1 Feb. 1999	18 Mar. 1999
Monash Unicomm Pty Ltd	31 Dec. 1998	" "	23 Mar. 1999	9 Apr. 1999
Monash University *(b)*	31 Dec. 1998	30 April. *Financial Management Act* 1994, s.46.	26 Apr. 1999	11 May 1999 *(a)*
Monash Ultrasound Pty Ltd	31 Dec. 1998	30 April. *Financial Management Act* 1994, s.53A.	1 Feb. 1999	19 Mar. 1999
Monash Ultrasound Trust	31 Dec. 1998	" "	1 Feb. 1999	23 Mar. 1999
Monash University Foundation Pty Ltd	31 Dec. 1998	" "	9 Mar. 1999	6 Apr. 1999
Monash University Foundation Year Ltd	31 Dec. 1998	" "	4 Feb. 1999	12 Mar. 1999
Monash University Foundation Trust	31 Dec. 1998	" "	9 Mar. 1999	6 Apr. 1999
Montech Medical Development Pty Ltd	31 Dec. 1998	" "	22 Feb. 1999	23 Mar. 1999
Montech Pty Ltd	31 Dec. 1998	" "	9 Feb. 1999	30 Mar. 1999
Neurometric Systems Pty Ltd	31 Dec. 1998	" "	4 Mar. 1999	18 Mar. 1999
RMIT University *(b)*	31 Dec. 1998	30 April. *Financial Management Act* 1994, s.46.	4 May 1999	12 May 1999 *(a)*
RMIT Foundation	31 Dec. 1998	30 April. *Financial Management Act* 1994, s.53A.	4 May 1999	12 May 1999

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*				
POST-SECONDARY EDUCATION INSTITUTIONS *- continued*				
Universities and associated companies - continued				
RMIT Innovation Ltd	31 Dec. 1998	30 April. *Financial Management Act* 1994, s.53A.	18 Mar. 1999	15 April 1999
RMIT International Pty Ltd	31 Dec. 1998	" "	15 Apr. 1999	15 Apr. 1999
RMIT (Malaysia) SDN BHD	31 Dec. 1998	" "	4 May 1999	12 May 1999
RMIT Resources Limited	31 Dec. 1998	" "	30 Mar. 1999	15 April 1999
RMIT Training Pty Ltd	31 Dec. 1998	" "	17 Mar. 1999	15 April 1999
RMIT Union	31 Dec. 1998	" "	11 Mar. 1999	24 Mar. 1999
School of Forestry Creswick Ltd	31 Dec. 1998	" "	6 Mar. 1999	25 Mar. 1999
School of Mines and Industries Ballarat Ltd	31 Dec. 1998	" "	29 Mar. 1999	11 May 1999
Sir John Monash Business Centre Pty Ltd	31 Dec. 1998	" "	29 Jan. 1999	24 Feb. 1999
Swinburne Ltd	31 Dec. 1998	" "	10 Mar. 1999	18 Mar. 1999
Swinburne University of Technology *(b)*	31 Dec. 1998	30 April. *Financial Management Act* 1994, s.46.	28 Apr. 1999	11 May 1999 *(a)*
Unilink Ltd	31 Dec. 1998	30 April. *Financial Management Act* 1994, s.53A.	3 May 1999	11 May 1999
University of Ballarat *(b)*	31 Dec. 1998	30 April. *Financial Management Act* 1994, s.46.	21 Apr. 1999	12 May 1999 *(a)*
University of Melbourne *(b)*	31 Dec. 1998	" "	30 April 1999	12 May 1999 *(a)*
Victoria University Enterprises Proprietary Limited	31 Dec. 1998	30 April. *Financial Management Act* 1994, s.53A.	1 Mar. 1999	29 Mar. 1999
Victoria University of Technology *(b)*	31 Dec. 1999	30 April. *Financial Management Act* 1994, s.46.	22 Apr. 1999	11 May 1999 *(a)*

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*				
POST-SECONDARY EDUCATION INSTITUTIONS *- continued*				
Universities and associated companies - continued				
Victoria University of Technology Foundation Ltd	31 Dec. 1998	30 April. *Financial Management Act* 1994, s.53A.	1 Mar. 1999	29 Mar. 1999
Victorian College of Agriculture and Horticulture Ltd *(f)*	31 Dec. 1998	" "	23 Mar. 1999	19 Apr. 1999
Victorian College of the Arts	31 Dec. 1998	30 April. *Financial Management Act* 1994, s.46.	12 May 1999	12 May 1999 *(a)*
Institutes/colleges of technical and further education and associated companies				
Angliss Consulting Pty Ltd *(g)*	31 Dec. 1998	30 April. *Financial Management Act* 1994 s.53A.	23 Mar. 1999	31 Mar. 1999
Bendigo Regional	31 Dec. 1998	30 April. *Financial Management Act* 1994, s.46.	25 Mar. 1999	26 Mar. 1999
Box Hill	31 Dec. 1998	" "	12 Mar. 1999	19 Mar. 1999
Box Hill Enterprises Ltd	31 Dec. 1998	30 April. *Financial Management Act* 1994, s.53A.	12 Mar. 1999	19 Mar. 1999
Central Gippsland	31 Dec. 1998	30 April. *Financial Management Act* 1994, s.46	14 Apr. 1999	15 Apr. 1999
Chisholm (*h)*	31 Dec. 1998	" "	24 Mar. 1999	30 Mar. 1999
East Gippsland	31 Dec. 1998	" "	25 Feb. 1999	19 Mar. 1999
Gordon Institute	31 Dec. 1998	" "	17 Mar. 1999	17 Mar. 1999
Goulburn Ovens	31 Dec. 1998	" "	22 Mar. 1999	24 Mar. 1999
Holmesglen	31 Dec. 1998	" "	9 Mar. 1999	10 Mar. 1999
Kangan Batman	31 Dec. 1998	" "	29 Mar. 1999	29 Mar. 1999
Melbourne Institute of Textiles *(i)*	31 Dec. 1998	" "	1 Apr. 1999	7 Apr. 1999

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*				
POST-SECONDARY EDUCATION INSTITUTIONS - *continued*				
Institutes/colleges of technical and further education - *continued*				
Northern Melbourne	31 Dec. 1998	30 April. *Financial Management Act* 1994, s.46.	1 Apr. 1999	7 Apr. 1999
South West	31 Dec. 1998	" "	23 Mar. 1999	29 Mar. 1999
Sunraysia	31 Dec. 1998	" "	29 Mar. 1999	29 Mar. 1999
William Angliss	31 Dec. 1998	" "	31 Mar. 1999	31 Mar. 1999
Wodonga	31 Dec. 1998	" "	12 Mar. 1999	18 Mar. 1999
INCOMPLETE AUDITS				
INSTITUTES/COLLEGES OF TECHNICAL AND FURTHER EDUCATION				
Driver Education Centre of Australia Ltd	31 Dec. 1998	30 April. *Financial Management Act* 1994 s.53A.	Audit substantially completed.	

(a) Audit report qualified.
(b) Extention of time for submission of financial statements granted by the Minister for Finance.
(c) Formerly Victorian College of Agriculture and Horticulture Services Ltd.
(d) Formerly Hawthorn International Education Ltd.
(e) Formerly Monash IVF Pathology Services Trust.
(f) Final audit. Company placed in the hands of a liquidator on 1 February 1999.
(g) Formerly William Angliss 2000 Pty Ltd.
(h) Barton, Casey and Peninsula Institutes of TAFE amalgamated to form Chisholm.
(i) Merged with RMIT on 1 January 1999.

Part 3.2

Human Services

KEY FINDINGS

Accountability of community health centres

- As community health centres become larger and responsible for the management of increasing levels of public resources, consideration needs to be given to their level of accountability to the Parliament and ultimately to Victorian taxpayers. As the Parliament's auditor, it will be important that the Auditor-General is involved in this accountability process.

  Paras 3.2.15 to 3.2.19

- To enable the effectiveness of community health centres to be evaluated, the Department needs to develop, as a matter of priority, qualitative indicators with particular emphasis on client outcomes. The results of the evaluation should be used by the Department in determining the basis for future Service Agreement negotiations.

  Paras 3.2.20 to 3.2.23

Financial viability of public hospitals

- An analysis of the financial viability of public hospitals as at 30 June 1998 revealed:
  - 60 hospitals (66 per cent) incurred a deficit, prior to grants received for capital purposes and transactions of an extraordinary nature;
  - 26 hospitals (28 per cent) had generated negative cashflows from their operating activities; and
  - 35 hospitals (38 per cent) had a negative working capital position.

  Paras 3.2.35 to 3.2.37

- In relation to the public hospitals showing signs of financial difficulty as at 30 June 1998 the Department of Human Services has advised that the financial position of certain of these hospitals had subsequently improved. It is the Office's intention to review the financial position of these hospitals as at 30 June 1999, based on audited information.

  Paras 3.2.41 to 3.2.44

KEY FINDINGS - *continued*

Maintenance of public housing

- The Department's information system indicates that, as at 30 June 1998, outstanding maintenance on its housing portfolio totalled $147 million, with a further $55 million required for the physical improvement and redevelopment of its properties.

Paras 3.2.53 to 3.2.60

- Based on the departmental advice that the information recorded on its housing portfolio maintenance database is out-dated, there is a clear need for the Department to establish appropriate information systems which record reliable information on the condition and future maintenance requirements of its property portfolio.

Paras 3.2.61 to 3.2.63

Condition of residential care facilities

- As at February 1999, Commonwealth Government certification had been obtained for 164 residential care facilities as providing accommodation that meets the established standards. However, 23 facilities containing 1 224 beds were yet to meet the certification standards.

Paras 3.2.69 to 3.2.72

- The Department advised that the major reasons for facilities failing the Commonwealth Government certification process were:
  - failure to meet fire safety standards;
  - poor privacy standards; and
  - the age and out-dated design of facilities.

Para. 3.2.73

Results of police and legal investigations into contractual practices at the Metropolitan Ambulance Service

- The external accountant engaged by the Department of Human Services to assist in determining whether there are grounds for commencing civil action to recover moneys was deeply critical of the actions of senior management at the time at the Metropolitan Ambulance Service and the resultant financial damage caused to the Service.

Paras 3.2.97 to 3.2.103

- The conclusion reached by senior counsel was that the costs and risks of suing for recovery of moneys were too high in relation to the amount at stake.

Paras 3.2.104 to 3.2.106

- While a judicial inquiry did not eventuate, I do draw comfort from the fact that senior legal counsel, expert police investigators and an experienced financial accountant formed views of the seriousness of the situation at the Service which mirrored my own and those of my staff.

Paras 3.2.107 to 3.2.112

3.2.1 The Minister for Health and Aged Care, the Minister for Youth and Community Services, the Minister for Housing and the Minister responsible for Aboriginal Affairs, have responsibility for operations within the Human Services sector. These Ministers have collective responsibility for the Department of Human Services.

3.2.2 Details of the specific ministerial responsibilities for public bodies within the Human Services sector are listed in Table 3.2A. In addition to the Department of Human Services, the entities listed below were subject to audit by the Auditor-General during the 1997-98 financial year.

TABLE 3.2A
MINISTERIAL RESPONSIBILITIES FOR PUBLIC BODIES WITHIN THE HUMAN SERVICES SECTOR

Ministerial portfolio	*Entities subject to audit*
Aboriginal Affairs	-
Aged Care	-
Youth and Community Services	-
Health	Advanced Dental Technicians Qualifications Board Ambulance Officers' Training Centre Alexandra and District Ambulance Service Ambulance Service Victoria - Metropolitan Region North Eastern Region North Western Region South Eastern Region South Western Region Western Region Anti-Cancer Council of Victoria Chiropodists Registration Board of Victoria Chiropractors Registration Board of Victoria Dental Board of Victoria Dental Technicians Licensing Committee Healthit Ltd Infertility Treatment Authority Medical Practitioners Board of Victoria Mental Health Review Board Nurses Board of Victoria Optometrists Registration Board of Victoria Osteopaths Registration Board of Victoria Pharmacy Board of Victoria Physiotherapists Registration Board of Victoria Prince Henry's Institute of Medical Research Psychologists Registration Board of Victoria Psychosurgery Review Board Public cemeteries - Anderson's Creek Cemetery Trust Ballarat General Cemeteries Trust Bendigo Cemeteries Trust

TABLE 3.2A
MINISTERIAL RESPONSIBILITIES FOR PUBLIC BODIES
WITHIN THE HUMAN SERVICES SECTOR *- continued*

Ministerial portfolio	*Entities subject to audit*
Health - *continued*	Cheltenham and Regional Cemeteries Trust
	Geelong Cemeteries Trust
	Keilor Cemetery Trust
	Mildura Cemetery Trust
	Preston Cemetery Trust
	Templestowe Cemetery Trust
	Trustees of the Fawkner Crematorium and Memorial Park
	Trustees of the Lilydale Memorial Park and Cemetery
	Trustees of the Memorial Park Altona
	Trustees of the Necropolis Springvale
	Wyndham Cemeteries Trust
	Public hospitals (90)
	Victorian Health Promotion Foundation
Housing	-

3.2.3 Comment on matters of significance arising from the audit of entities within the Human Services sector is provided below.

ACCOUNTABILITY OF COMMUNITY HEALTH CENTRES

3.2.4 Community health centres provide a wide range of medical, pharmaceutical, allied health, respite and other services to the local community, with an emphasis on particular priority groups, such as low income earners, people with chronic health conditions, the homeless and young people. The centres are incorporated under the *Associations Incorporation Act* 1981 and are declared as community health centres under the *Health Services Act* 1988, with the Board of Management of each centre appointed by the Governor in Council on the recommendation of the Minister for Health.

3.2.5 In recent years, the number of centres has been rationalised with the aim of improving their viability, and increasing their size and the range of services provided. At 30 June 1998, there were 43 stand-alone centres operating in Victoria, not including those operating as part of hospital networks which are accountable to the Parliament.

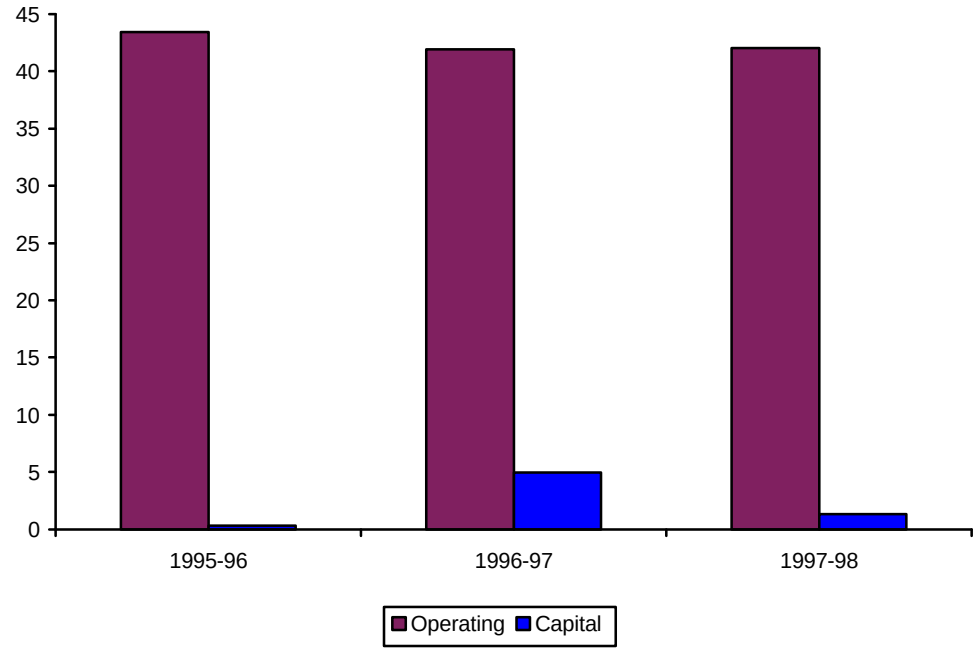
Community health centres provide a wide range of health and other services to the local community.

Funding of centres

3.2.6 Around 85 per cent of the total revenue of the stand-alone centres is provided by the State via the Department of Human Services. In addition, centres obtain funds from the Commonwealth Government and local government agencies, client fees, fundraising activities, business undertakings, investments and the sale of assets.

3.2.7 In the 1997-98 financial year, these centres received funds totalling $43.3 million ($42 million for operating purposes and $1.3 million for capital purposes) from the Department, through the Community Health Program. Funding provided by the Department for the 3 year period to 30 June 1998 has remained relatively stable as shown in Table 3.2B below.

TABLE 3.2B
FUNDING PROVIDED BY THE STATE FOR COMMUNITY HEALTH CENTRES, 3 YEAR PERIOD TO 1997-98
($million)



Previous audit review

3.2.8 The May 1989 *Report on Ministerial Portfolios* commented on the developing role of community health centres in providing expanded community health services and identified the need for the Department to develop performance indicators to evaluate the efficiency and effectiveness of services delivered by centres, and to improve the monitoring of centres to ensure proper accountability for government funding. In its response to that Report, the Department acknowledged the need for performance indicators and better accountability and stated that these issues would be resolved following the full implementation of Health Service Agreements in 1991.

3.2.9 Given that the centres play a significant role in the Department's delivery of health services to the community, and are responsible for the management of substantial levels of public resources, an audit review was undertaken to assess the accountability of these centres.

Delays in finalisation of Health Service Agreements

3.2.10 Since 1991, the Department has required all centres to enter into service agreements which represent a contractual obligation for the level and range of services to be provided by centres for an agreed amount of funding. The agreements entered into are known as Community Health Centre Service Agreements (Service Agreements).

3.2.11 For the 1998-99 financial year, audit found that there were delays in finalising these Service Agreements. Only 52 per cent of Service Agreements had been signed by 31 December 1998, and a further 40 per cent had been signed by 31 March 1999.

3.2.12 Service Agreements contain 5 Schedules, one of which includes Service Plans which detail the range and level of services to be provided by the centre. The Department advised audit that for the 1998-99 financial year, all Service Plans had been agreed with individual centres, even though the Service Agreements may not have been signed.

3.2.13 The formal agreement of funding and service targets in a timely manner is critical to the efficient and effective implementation of the purchase/provider arrangements with centres to enable them sufficient time to confidently plan and implement operational strategies which meet the agreed targets. Consequently, the early finalisation of Service Agreements, ideally prior to the commencement of a financial year, would be beneficial in terms of enhancing accountability and enabling the Department to take appropriate action if agreed targets are not met.

3.2.14 **It is of concern, that in the event of a dispute arising between the Department and a centre regarding funding and service provision, the absence of a formal agreement detailing the rights, obligations, and liabilities of the respective parties could result in inadequate accountability, less than optimal performance or financial loss.**

Accountability of centres and monitoring of their operations

3.2.15 As part of the accountability and reporting framework which forms part of the Service Agreements, centres are required to submit regular financial and statistical data to the Department. This information is used by the Department to assess the financial viability of centres, monitor and target the delivery of services, and assist in future funding decisions.

3.2.16 The audit review revealed that:

- There were delays in the Department collating the information provided by centres which severely limited the usefulness of the information as a management tool. For example, a departmental report identifying major funding sources and staffing levels of centres, and used to monitor broad industry trends and changes in service provision, was last available to departmental management with data only relating to the 1996-97 financial year;

- Little checking was performed by the Department to verify the accuracy of the statistical data submitted by centres and used by the Department for management and planning purposes; and
- There is no reporting to the Parliament on the financial performance of centres or their effectiveness in the delivery of services.

3.2.17 In addition to the specific financial and statistical data which is required to be provided to the Department, the centres are also required to submit to the Department annual audited financial statements. These statements, required to be audited by a registered company auditor, are a key document to ensure the proper accountability of government funds. However, audit found that:

- there is no departmental prescribed format for the annual financial statements and the reporting formats used by centres were not consistent;
- statements are not always received by the Department in a timely manner; and
- little use of the statements was made by the Department and they were not used to verify the accuracy of the other financial information submitted.

3.2.18 **There is a need for the reporting framework of community health centres to be enhanced to ensure appropriate accountability over their expenditure of government funds. The Department should also prescribe a format for the preparation of the annual audited financial statements for consistent reporting by centres to allow comparison of financial performance.**

3.2.19 **Furthermore, as centres become larger and responsible for the management of increasing levels of public resources, consideration needs to be given to their level of accountability to the Parliament and ultimately to Victorian taxpayers. As the Parliament's auditor, it will be important that the Auditor-General is involved in this accountability process.**

Monitoring the effectiveness of services provision

3.2.20 The May 1989 *Report on Ministerial Portfolios* recommended that to enable the efficiency and effectiveness of centres to be evaluated, the Department should institute procedures to assist centres with the development of performance indicators, with particular emphasis on indicators focusing on client outcomes. The Department agreed with this recommendation and advised that this would be addressed with the full implementation of Health Service Agreements in 1991.

3.2.21 In the 1997-98 financial year, the Department introduced a purchasing framework across its various service delivery functions, including community health services, which was aimed at implementing a purchaser/provider relationship, developing consistency of service purchasing across the State, and introducing competition into the delivery of government services and was a shift away from purchasing on the basis of inputs towards the purchasing of outputs.

3.2.22 Audit identified that despite the Department's modified role from a provider of services to the role of purchaser, there has been no change in the performance indicators incorporated into current Service Agreements. The audit review of Service Agreements revealed that performance indicators generally continue to be based on inputs rather than outputs and, in those instances where they are based on outputs, they are quantitative in nature. In this regard, some of the key performance indicators included in Service Agreements are contact and session hours, and fee revenue targets.

3.2.23 **In audit view, the current performance indicators established for community health centres do not enable the effectiveness of particular services or programs to be evaluated. To enable the effectiveness of centres to be evaluated, the Department needs to develop, as a matter of priority, qualitative indicators with particular emphasis on client outcomes. The results of the evaluation should be used by the Department in determining the basis for future Service Agreement negotiations.**

Asset management

3.2.24 Asset management provisions incorporated into Service Agreements require centres to maintain a register of all assets valued at $1 000 or more which were purchased from funds provided by the Department. Each centre is required to annually provide a copy of the assets register to the Department. Also, the Secretary of the Department must be informed in writing of any disposal or transfer of these assets by centres. These procedures are included in the Service Agreements as a means of ensuring that centres adequately control and record their government-funded assets. In addition, advising the Department of any disposal or transfer of assets previously funded by the Department provides some assurance that assets are not transacted in a manner detrimental to the interests of the State.

3.2.25 Since 1996-97, the Department has implemented a change in administrative arrangements which require centres requesting significant funding for the purchase of property or the capital improvement of existing buildings to sign a Property of Deed. This change in administrative arrangements provides a legal safeguard over property occupied by centres in which the Department has a financial interest. This effectively means a caveat is placed on the title of the property and the Department will be notified by the Registrar's Office of any transactions involving a particular property.

3.2.26 Audit has been further advised that, in line with recent government policy initiatives, any unreserved Crown land controlled by the Department of Natural Rsources and Environment (DNRE) but used for purposes funded by other portfolios is to be transferred to the control of the funding portfolio and be reported in the funding portfolio's annual financial statements. Under these proposals, land occupied by a centre would be reserved for health service purposes and the Secretary to the Department appointed as a Committee of Management. This process has been underway for a number of years, however, at the date of preparation of this Report, no proposed date of completion has been set by DNRE.

3.2.27 **The process of identifying Crown land occupied by centres has been underway for a number of years. Given the business relationship between the Department and centres it may expedite matters if the Department took a more proactive role in the identification of such land. This land could then be reserved for human service purposes and be accounted for in the annual financial statements of the Department.**

Planned reforms

3.2.28 There are a number of agencies responsible for the funding and management of primary health and community support services, including the Department through its centres, some hospitals and primary care agencies, the Commonwealth, local government through its Home and Community Care programs, and the private sector through general practitioners, pharmacists etc. The Department has acknowledged, however, that these services are not integrated, lack co-ordination, and their delivery lack quality assurance and practice standards.

3.2.29 In December 1998, the Department released a Policy Directions Paper endorsed by the Minister of Health with the aim to:

> *"... improve the health status of and quality of life of the community, encourage independence and reduce the burden of disease, ill-health and disability, by creating a robust, integrated, consumer responsive primary health and community support service system".*

3.2.30 The core element of this reform is to design local service systems which are client-centred, based on a model of social health, functionally integrated and linked in a structured way with the broader care and support system. To achieve this, the Department proposes to purchase Primary Health and Community Support services on the basis of defined local catchments, streamline accountability requirements by developing a purchasing framework, ensuring clear and appropriate links between local, sub-regional, regional, Statewide and specialist services, and facilitate the development of improved information systems with strong safeguards for privacy and confidentiality, and implement the reforms incrementally through demonstration projects over the next 2 to 3 years.

3.2.31 The key outcomes expected from the reform process are:

- improved service accessibility, quality and responsiveness to clients;
- increased provider capacity to implement the new approach to health which emphasises prevention and maximises consumer independence;
- increasing health services cohesion, including the development of an output-based purchasing framework and increasing the usage of information technology and information management systems; and
- creating service co-ordination links within the broader healthcare system.

3.2.32 The Department expects the improved service systems to be implemented across Victoria by the year 2003.

❒ ***RESPONSE*** *provided by Secretary, Department of Human Services*

Service agreements

The Department accepts that it is essential that services provided on behalf of government need to be closely monitored to ensure that agreed services are delivered in accordance with service plans and within the agreed price. The Department initiated a Service Agreement process to better manage the provision of services and annually reviews the process to ensure that:

- *agencies are able to clearly understand the agreement process; and*
- *that impediments to the implementation of the strategy are addressed.*

Eventually, payments will be made to agencies linked to service delivery and the achievement of agreed outputs. The rationalisation of community health centres and in some instances amalgamation with health networks has enhanced the Department's and agency's ability to improve the Service Agreement process and monitoring and accountability.

Monitoring and accountability

A key corporate initiative of the Department is the Transforming Business 21 (TB21) project which seeks improved outcomes for clients through better management of public resources and business processes. One of TB21's 6 major business initiatives is "Purchasing Client Services", the fundamental aim being to ensure that the community receives the best outcomes for the dollars invested in services.

This aim will be achieved through a range of initiatives such as:

- *the improvement and uniformity of business processes for the purchasing of client services;*
- *simplification of reporting requirements and the development of information systems in the Department to support the purchasing process to ensure providers are delivering best value for money; and*
- *ensuring departmental purchasing frameworks have useful performance measurement and accountability mechanisms.*

In regard to the development of qualitative performance measures, in 1998-99 the Aged Community and Mental Health Division commenced development and implementation of a performance measurement framework which addresses a range of issues related to performance indicators for 1999-2000. The development of qualitative performance measures and improved quantitative measures for community health centres has been identified as a priority for 1999-2000.

Another key corporate initiative that will address audit's concerns about the accountability framework and qualitative performance measures is the Primary Health and Community Support (PHACS) redevelopment. The Department is investing significant resources into this redevelopment including the revision of the Aged, Community and Mental Health Purchasing Framework, development of a health outcomes approach to purchasing and investing in the information management capacity within the sector.

❒ ***RESPONSE*** *provided by Secretary, Department of Human Services - continued*

In regard to the concern raised by the Report in terms of consistency for financial reporting the Financial Accountability Returns (FAR) contained as a Schedule within the Service Agreement, provides agencies with sample financial returns and nominates the data required. All agencies are provided with the same suite of pro-formas and are expected to provide data within 90 days after the end of the financial year. The FAR enables the comparison of financial performance. The Department will investigate and discuss with the industry the feasibility of providing a standard format as a guide for the preparation of annual audited financial statements. Stand-alone agencies are currently required to provide annual reports under the Incorporations Act. These reports are required to be audited by a suitably qualified person in accordance with the relevant accounting standards.

Asset management

In response to the Report recommendation relating to asset management, the Department will investigate and identify the land holding arrangements of all centres in order to confirm ownership details and how these are reflected in annual financial statements. Where centres are found to be operating on Crown land which has not been reserved for a health purpose or a Committee of Management (COM) appointment has not been made for the land, then the Department will implement arrangements for the Secretary of DHS to be appointed as COM for the land. The land and buildings will then be incorporated in the DHS financial statement.

Finally, the Department is cognisant of the issues raised in the Report and has key corporate initiatives addressing these challenges.

VIABILITY OF PUBLIC HOSPITALS

3.2.33 My previous Reports to the Parliament have commented on the deteriorating financial position of a number of hospitals and the steps taken by the Department of Human Services to improve the financial performance of those hospitals, which has included the provision of loans to assist management in the orderly restructure of hospital operations in order to improve their financial position.

3.2.34 Given the previously identified financial difficulties faced by hospitals, audit undertook a review to:

- determine whether any hospitals were currently experiencing financial difficulties or displaying signs of declining financial performance;
- assess the Department's effectiveness of monitoring the financial performance of hospitals and ascertain how any funding shortfalls are being overcome; and
- review the adequacy of any government action to ensure hospitals revert to a financially viable position.

The capacity of hospitals to deliver high quality health services is dependent upon their ability to maintain a sound financial position.

Hospitals displaying signs of financial difficulties at 30 June 1998

3.2.35 It is generally accepted that a key indicator of an organisation's financial viability is its capacity to meet current liabilities from available current assets as and when they fall due. Accordingly, one of the measurements to determine viability is the working capital position which compares liabilities falling due for payment in the next 12 months, such as creditors and employee entitlements, against assets that typically provide the funds to extinguish those liabilities.

3.2.36 Audit analysed the financial viability of all 90 public hospitals as at 30 June 1998 by examining their working capital position at year-end, together with the following 2 additional key financial indicators:

- operating result for the 1997-98 financial year, prior to grants received for capital purposes and transactions of an extraordinary nature; and
- net cash flows generated from operating activities during the 1997-98 financial year.

3.2.37 **The audit examination revealed that, during the 1997-98 financial year:**

- **60 hospitals (66 per cent) incurred a deficit, prior to grants received for capital purposes and transactions of an extraordinary nature;**
- **26 hospitals (28 per cent) had generated negative cashflows from their operating activities; and**
- **35 hospitals (38 per cent) had a negative working capital position.**

3.2.38 Table 3.2C identifies the hospitals which, based on the results of the audit analysis of the previously-mentioned financial indicators, are considered to be operating under financial difficulty as at 30 June 1998, which may impact on their ability to meet future financial obligations as and when they fall due.

TABLE 3.2C
PUBLIC HOSPITALS SHOWING SIGNS OF FINANCIAL DIFFICULTY, AS AT 30 JUNE 1998*(a)*
($'000)

Hospital	*Operating deficit prior to capital grants and extraordinary items*	*Net cash outflows from operating activities*	*Negative working capital position*
North Western Health Care Network	40 209	21 275	52 888
Austin and Repatriation Medical Centre	30 312	27 846	25 725
Latrobe Regional Hospital *(b)*	6 335	4 923	17 405
Peninsula Health Care Network	4 670	688	6 300
Mildura Base Hospital	3 874	3 233	5 743
Mercy Public Hospitals Incorporated	3 082	1 852	4 707
Alpine Health	1 473	511	1 235
Dental Health Services Victoria	1 415	2 354	1 372
Wodonga Regional Health Service	1 342	498	874
Wonthaggi and District Hospital	1 012	426	384
Bairnsdale Regional Health Service	911	175	794
Caritas Christi Hospice Ltd	738	976	633
Hamilton Base Hospital	565	412	590
Rochester and Elmore District Health Service	456	267	511
Maffra District Hospital	289	38	106
Heywood and District Memorial Hospital	106	169	229
O'Connell Family Centre (Grey Sisters) Inc.	103	57	101
Maldon Hospital	90	26	107

(a) Based on audited financial statements.
(b) As from 1 September 1998, the operations of the Hospital was transferred to the private sector.

Actions to improve financial performance of hospitals

3.2.39 Over recent times the Department has initiated restructuring of public hospitals aimed at ensuring an effective and efficient sector, including:

- the rationalisation of 45 metropolitan hospitals through the amalgamation of their operations into 5 metropolitan health care networks; and
- the amalgamation of a number of rural hospitals and other health service providers with the objective of providing more effective and efficient health services to regional areas.

3.2.40 In addition, the Department has provided financial assistance in the form of loans or grants to a number of hospitals in order to assist in the orderly restructure of their operations so that the hospitals are able to operate within their funding levels.

3.2.41 To ensure the financial viability of hospitals and their ability to meet benchmark prices, the Department actively monitors hospital financial performance through a framework which includes:

- monthly electronic reporting to the Department of financial and performance data by each network and hospital;
- analysis by the Department of defined qualitative and quantitative indicators against benchmarks; and
- regular discussions between the Department and individual hospitals on budget and performance issues.

3.2.42 A monthly report on the financial performance of the major service providers is provided to executive management of the Department, from which appropriate actions may be taken should liquidity problems emerge with any specific hospital. The regional centres of the Department also perform a similar monitoring role for rural hospitals and provide quarterly reports to the Department's executive management.

3.2.43 Where a hospital is identified as being at financial risk, the Department generally initiates action which includes:

- isolating key problems affecting poor financial performance and implementing change where necessary;
- identifying strategies and actions, through the development of a business plan, to address the existing problems; and
- ensuring the hospital is maintaining and reporting accurate financial data.

3.2.44 In relation to the public hospitals showing signs of financial difficulty as at 30 June 1998 which have been identified in Table 3.2C, the Department has advised that the financial position of certain of these hospitals had improved subsequent to that date. It is my intention to review the financial position of these hospitals as at 30 June 1999, based on audited information.

3.2.45 In the 1998-99 financial year, the negotiation between the Commonwealth Government and the State and Territory jurisdictions of the Australian Health Care Agreement, and new funding arrangements for the treatment of war veterans, resulted in Victoria receiving an additional $134 million in health funding from the Commonwealth Government. In addition, the Government provided a further $134 million to hospitals to meet the growth in health care demand. These additional funds should assist in the easing of the financial pressures facing hospitals.

❒ ***RESPONSE*** *provided by Secretary, Department of Human Services*

This Report relies on 1997-98 information already in the public domain. In addition, the audit exaggerates the number of hospitals facing financial difficulty at 30 June 1998, and the level of that difficulty, by including depreciation as an operating expense but excluding capital grants which fund most hospital asset replacements.

The pressures on hospitals to deal with increasing levels of demand within constrained resources was fully acknowledged by the Department and the Government at that time.

It was for this reason that Victoria, along with all other States, was determined to achieve a significant benefit from renegotiation of the Australian Health Care Agreement (AHCA) to run from 1998-2003. This has subsequently occurred and resulted in increased funding to the Victorian hospital sector of $134 million in the 1998-99 year. This additional funding, on top of the $134 million increase announced as part of the 1998-99 State budget, resulted in a total increase of $268 million in the current financial year to hospitals - a record increase.

This increase, along with sound management strategies in the sector, has lead to a dramatic financial turnaround, with current data projecting an end-year surplus by hospitals and networks in excess of $20 million.

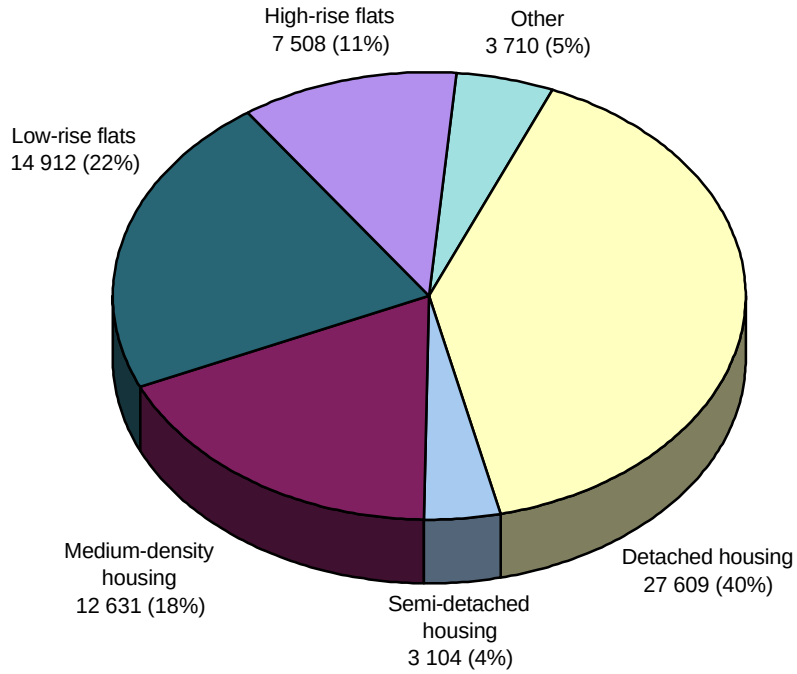
All of this further information was requested by, and provided to, audit during the course of this review. It is therefore unfortunate that, although audit refers to the increased AHCA funding, this funding is not reflected in the viability assessment presented by audit. The Report, therefore, while reflecting an historic perspective, does not contribute to contemporary policy deliberation.

MAINTENANCE OF PUBLIC HOUSING

3.2.46 As at June 1998, the Department of Human Services had responsibility for 69 500 rental dwellings which were utilised for the purpose of providing public housing (64 250) and community housing (5 250), and had an aggregate value of around $5.7 billion.

3.2.47 The Department's housing portfolio is located throughout Victoria, with a concentration in the Melbourne metropolitan area (67 per cent). The structural profile of the portfolio is diverse and includes high-rise flats (over 8 storeys), low-rise flats, medium-density housing, and semi-detached and detached housing. The profile of the Department's housing stock as at 30 June 1998, is outlined in Chart 3.2D.

CHART 3.2D
COMPOSITION OF HOUSING ASSET PORTFOLIO, AS AT 30 JUNE 1998



3.2.48 A key responsibility of the Department is to ensure that its housing property portfolio is adequately maintained in order to retain its value and to provide a satisfactory standard of accommodation for tenants which have constantly changing requirements, including special needs.

3.2.49 Previous Reports of the Auditor-General to the Parliament have included comment on the adequacy of public housing maintenance by the Department of Human Services and its predecessors. In particular, the May 1993 *Report on Ministerial Portfolios* identified that:

- a pro-active preventative approach to the maintenance of public housing had not been developed by the then Department of Planning and Development; and
- the Department lacked information on the physical condition of properties.

3.2.50 Further audit comment on the maintenance of public housing was provided in the November 1996 *Special Report No 46: Public Housing - Responding to a fundamental community need*, which highlighted that the Department had completed a physical inspection of properties in December 1995 which had identified that over $308 million in maintenance expenditure was required by the year 2000 to bring properties up to an acceptable standard. Audit also reported that the Department had implemented a number of initiatives aimed at reducing the maintenance backlog and at obtaining more efficient use of maintenance funds, including the development of a co-ordinated maintenance works program to better target improvement and upgrade works to those properties which were intended to be retained in the longer-term.

3.2.51 A follow-up review was undertaken by audit of public housing maintenance in order to assess the adequacy of existing maintenance levels through cyclical, preventative and urgent maintenance programs, and to determine the extent of any backlog maintenance.

Property condition information system

3.2.52 In earlier years, little attention had been given by the Department to systematically addressing the cyclical maintenance requirements of the housing portfolio to prevent deterioration in its condition. Rather, maintenance was essentially provided in an ad-hoc and reactive manner.

An example of repairs required to roof guttering.

3.2.53 In the period February 1994 to December 1995, the Department completed a detailed physical inspection of 93 per cent of properties, including community-managed housing stock. The physical inspection enabled the establishment of a property condition database which included an estimate of the costs of maintenance and capital upgrades required to bring properties up to an acceptable condition.

3.2.54 Properties were initially inspected by a combination of employees and external consultants with experience in the building industry. However, inconsistent application of the Department's guidelines by assessors raised concerns within the Department as to the accuracy of the data recorded in the property condition database. To overcome these concerns, the Department initiated a program to inspect every property over a 5 year cycle. As at 31 January 1999, the Department had completed the inspection of over 35 000 properties. The results of this program to date, supplemented by inspections undertaken when tenants request maintenance on properties and when properties are vacated by tenants, has assisted the Department in ensuring that the data contained in the property condition database is current and accurate.

3.2.55 Table 3.2E provides an outline of the assessed condition of departmental housing including the estimated level of upgrade and maintenance expenditure required to improve properties to a good condition.

TABLE 3.2E
PROPERTY CONDITION, AT 30 JUNE 1998

Property condition	*Properties*	*Total estimated maintenance cost*	*Total estimated capital upgrade/ improvement cost*	*Total estimated cost*
Estimated cost of upgrade and maintenance per property	*(no.)*	*($m)*	*($m)*	*($m)*
Excellent (nil)	31 944	nil	nil	nil
Good ($1 to $5 000)	25 716	45.4	26.0	71.4
Fair ($5 001 to $20 000)	7 079	63.0	24.6	87.6
Poor ($20 001 to $30 000)	300	7.1	2.1	9.2
Very Poor (Greater than $30 000)	77	3.1	0.6	3.7
Condition not recorded	3 628	n/a	n/a	n/a
Block costs *(a)*	n/a	21.5	n/a	21.5
Surplus properties	730	6.7	2.4	9.1
Total	**69 474**	**146.8**	**55.7**	**202.5**

(a) Block costs are those costs which cannot be attributed to an individual residence but relate to a group of residences, e.g. electricity supply, lifts, boilers etc. in low-rise and high-rise flats.

3.2.56 Table 3.2E shows that almost 95 per cent of the total housing stock as at 30 June 1998 has been assessed by the Department as fair, good or excellent. This assessment is consistent with the findings of the Commonwealth Government-appointed Steering Committee for the Review of Commonwealth/State Service Provision. As part of the Steering Committee's review, the results of which were included in its February 1999 *Report on Government Services,* the Committee conducted a survey of the condition of public housing throughout Australia. While the Committee did caution that the survey methodology needed to be refined to improve the consistency of the data, the results indicated that around 99 per cent of public housing stock in Victoria was in good condition and compared favourably with that in other States.

Properties not recorded or inspected

3.2.57 The above table indicates that there are over 3 600 properties where the property condition has not been recorded in the Department's database. Within this group of properties were 1 550 dwellings acquired prior to December 1995 which the Department has not inspected, mainly due to tenants not permitting access. The remainder of properties (2 050 dwellings) were those that have been purchased or constructed since 1995.

3.2.58 **As the successful management of maintenance requirements depends on the Department's ability to ensure the ongoing integrity and completeness of maintenance needs recorded on its information systems, the Department should ensure that a high priority is given to the inspection of these properties.**

An example of inner city high-rise and medium-density public housing.

Level of outstanding works

3.2.59 A major aim of the Department is to improve the quality of the housing stock that is to be retained in the medium to long-term. The information contained in the property condition information systems allows the Department to evaluate and prioritise the properties that are most in need of programmed maintenance and upgrades, after considering whether the property is required in the medium to long-term and the available level of funding. Responsive maintenance is undertaken as required on all properties consistent with the requirements of the *Residential Tenancies Act* 1997.

3.2.60 As shown in the above table, the Department's information system indicates that, as at 30 June 1998, outstanding maintenance on its housing portfolio totalled $147 million, with a further $55 million required for the physical improvement and redevelopment of its properties.

3.2.61 However, the Department advised that a total of 4 325 properties were included in their information system which had been identified for sale or demolition, and were expected to be retained for less than 5 years. As a result, the Department did not intend to undertake programmed maintenance or upgrade works on these properties, but will perform responsive maintenance works as required in order to meet its responsibilities under the *Residential Tenancies Act* 1997. Consequently, the Department did not expect to undertake works costing around $35 million and $18 million on maintenance and upgrade costs respectively on these properties.

3.2.62 The Department further advised that its information systems do not reflect the required level of future maintenance and upgrade works, given that expenditure undertaken since the previous property inspections is not recorded and the level of outstanding works adjusted until the properties are next inspected.

3.2.63 **Based on the above advice, there is a clear need for the Department to establish appropriate information systems which record up to date and reliable information on the condition and future maintenance requirements of its property portfolio.**

❒ ***RESPONSE*** *provided by Secretary, Department of Human Services*

Properties not recorded or inspected

The Department has a rolling 5 year program of inspections to provide for all properties to be inspected. In addition, this program is supplemented by inspections undertaken when tenants request maintenance or as properties are vacated.

Tenants are entitled to the quite enjoyment of their rental property and do not always grant access for property inspection purposes. Given the relatively small number of properties still to be inspected and the fact that the information is primarily used for planning purposes the Department does not consider it appropriate to seek access orders from the Residential Tenancies Tribunal for this purpose. However, the Office of Housing continues to give priority to seeking tenant agreement to inspections of these properties on vacancy and requests for maintenance.

Level of outstanding works

The primary functions of the rolling 5 year inspection program are to monitor the overall property condition of the housing portfolio and to assist in the planning and prioritising of programmed maintenance and upgrade works. Accordingly, the Department is developing systems which will electronically update property inspection data when significant maintenance or upgrade works are undertaken.

CONDITION OF RESIDENTIAL CARE FACILITIES

3.2.64 Residential care services for frail aged persons and younger disabled persons are delivered within Victoria through a network of public, private and voluntary facilities, commonly known as nursing homes and hostels. Traditionally, nursing homes have catered mostly for aged persons requiring extended care and involving high nursing dependency, but who do not warrant admission to acute care hospitals. Hostels have generally catered for aged persons requiring lesser levels of care.

3.2.65 In the past, under Commonwealth legislation, residential care facilities were required to operate as either nursing homes or hostels. However, with recent legislative changes, residential care facilities may now contain a combination of high nursing dependency beds and low-care beds.

3.2.66 In July 1993, the Department of Human Services published a policy document titled *Everyone's Future: Directions for Aged Care Services in the 1990's* which outlined various proposed reforms to restructure the State's role in the provision of residential care services, including:

- restructuring of the State's geriatric centres to provide residential care, and sub-acute health, rehabilitation and other specialist services;
- reducing the number of public sector residential care beds by closing 342 State nursing home beds and transferring 10 per cent of the State-owned nursing home beds to the private and voluntary sectors; and
- improving the quality of public sector nursing homes.

3.2.67 Consistent with this policy, as the first stage of reducing the number of publicly-provided nursing home beds, the Government in 1995 transferred 100 aged care beds from the Bairnsdale Regional Health Service to privately-owned and operated facilities in the region.

3.2.68 As part of a drive to improve the quality of State-owned residential care facilities, the Department engaged consultants in 1996 to conduct a physical inspection of the State's 10 geriatric centres and 79 of the 110 State-owned nursing homes. The consultants found, *inter-alia*, that a number of buildings were in a poor to reasonable physical condition and did not comply with fire safety requirements. The consultants estimated that the indicative maintenance and upgrade costs to address these concerns were in the order of $198 million.

Condition of facilities

3.2.69 As part of the Commonwealth Government's initiatives to reform aged care in Australia, all residential care facilities, from January 2001, must be accredited in order to charge residents accommodation fees and to be entitled to receive Commonwealth Government funding. To achieve accreditation, residential care facilities will have to provide specific standards of nursing care and meet certain accommodation criteria which cover such things as the structural soundness of buildings, safety issues, and privacy and amenity standards.

A recently constructed residential care facility.

3.2.70 During 1997, the Commonwealth conducted an inspection of residential care facilities across Australia to assess whether the facilities met the certification standards which will be required as from January 2001. As part of this process, each facility was assessed against the accommodation criteria and was required to score a minimum of 57 out of 100 points to achieve certification.

3.2.71 The physical assessment of residential care facilities was completed by the Commonwealth in October 1997. Of the 173 State-owned facilities reviewed at that time, 81 nursing homes and 54 hostels received Commonwealth certification. Accordingly, a total of 38 State-owned facilities, made up of 33 nursing homes and 5 hostels, failed to meet the Commonwealth's certification standards. However, a further 10 nursing homes and 7 hostels were not assessed.

3.2.72 **Since the above review, a number of facilities have carried out works to rectify identified problems and have subsequently been re-assessed by the Commonwealth Government. As at February 1999, certification has been obtained for 164 facilities, however, 23 facilities containing 1 224 beds were yet to meet the certification standards, with one facility yet to be assessed by the Commonwealth.**

3.2.73 **The Department advised that the major reasons for facilities failing the Commonwealth Government certification process were:**

- **failure to meet fire safety standards;**
- **poor privacy standards; and**
- **the age and out-dated design of facilities.**

Strategies to meet certification standards

3.2.74 Consistent with the principles espoused in the Department's 1993 policy on aged care services, the Department has continued to reduce the number of public sector residential care beds. As at 30 June 1998, a total of 485 beds had been transferred to private and voluntary operators.

3.2.75 During the 1998-99 financial year, a further 775 residential care beds are expected to be withdrawn from 9 public sector facilities, including the Kingston Centre, Grace McKellar Centre, Anne Caudle Centre and the Caulfield General Medical Centre, and transferred to private sector and voluntary operators.

3.2.76 In February 1999, the Department announced a further transfer of 1 000 beds to non-public sector operators, commencing in late 1999. The Department had not identified the facilities from which these beds will be transferred but has advised that it will take into consideration the outcome of the Commonwealth certification process, the results of a departmental building fabric survey and potential upgrade costs.

3.2.77 **Once completed, the government reform process will result in the transfer of almost 2 300 residential care beds to private and voluntary operators which will leave around 5 000 beds in government-owned facilities.**

3.2.78 In respect of the 23 facilities that failed to achieve certification as at February 1999, the Department has approved capital works to be undertaken at an estimated cost of $52 million. At the date of preparation of this Report, the Department was also evaluating further capital works projects which were estimated to cost $25 million and were considering whether a number of beds located at 4 facilities should be transferred to non-public sector operators or whether these facilities will receive future capital works funding.

3.2.79 **The preliminary timeframes for the completion of capital works programs indicate that 2 approved projects and 11 proposed projects, are not scheduled to be completed until after January 2001. Consequently, under current Commonwealth Government legislation, these facilities will not be able to charge patients accommodation fees or receive Commonwealth funding. Under these circumstances, the financial viability of these facilities will be at serious risk, with the operating funding shortfall likely to be required to be met by the State.**

3.2.80 **Based on the results of the Commonwealth Government certification process, a further 23 State-owned facilities containing 626 beds merely achieved the minimum standard required for certification. As the Commonwealth Government is committed to continuous improvement of residential care facilities, there is a likelihood that more stringent accommodation standards will apply in the future. Accordingly, the Department will also need to develop strategies to ensure these facilities continue to meet the required standards.**

❐ ***RESPONSE*** *provided by Secretary, Department of Human Services*

The Report outlining the results of the maintenance of State-owned residential care facilities has confirmed the Department's reform strategy for these services as outlined in the policy document Everyone's Future: Directions for Aged Care Services in the 1990s, published in July 1993.

The Report has found a range of initiatives undertaken by this Department to be consistent with that policy:

- *transfer of a total of 485 aged care beds to private and voluntary sector operators;*
- *the continuing program of transfer projects which currently involves a further 775 residential;*
- *conduct of an extensive fabric survey to State-owned residential care facilities in 1996; and*
- *capital works strategy to redress the concerns identified in that fabric survey.*

The Report found that, as at February 1999, 164 aged care facilities had achieved building certification by the Commonwealth Aged Care Program. A total of 23 State-owned facilities had failed to meet those certification standards. In respect of these facilities, the Department has proposed capital works totalling $52 million.

The Report notes that preliminary timeframes for the completion of these capital works indicated that 2 approved projects and 11 additional projects are not scheduled to be completed prior to January 2001 when facilities, which are not certified, will be defunded by the Commonwealth. This is a matter under discussion between this Department and the Commonwealth State Office and is an issue not particular to public sector facilities, but one which is significant in private and voluntary sector services in this and other States.

The Department is committed to achieving redevelopment of those services which are to be retained in the public sector within the shortest possible timeframe and will take additional measures, as necessary, to ensure that current buildings meet minimum standards.

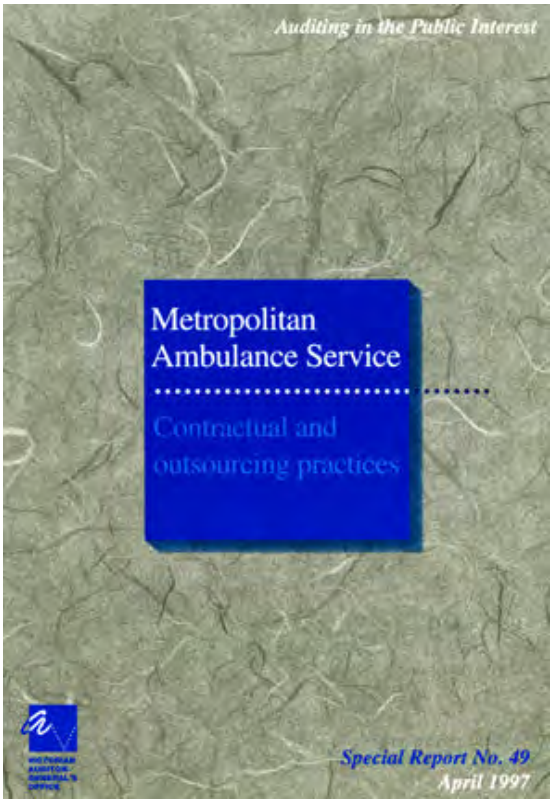
The Report states that the Department will need to develop strategies to ensure that these and other public facilities continue to meet Commonwealth accommodation standards. As the Report says, these standards are expected to require additional improvement, although in some areas it is also possible that the current standards may be slightly relaxed. The Department's Aged Care Program, in conjunction with the Capital Management Branch, has a number of strategies in place to address fire safety standards in particular. In addition, the transfer projects process will continue to achieve reduction of public sector services to the level necessary to fulfil this State's policy commitments in aged care. The Department maintains good effective liaison with the Federal Department to ensure the ongoing provision of effective, efficient and quality services.

RESULTS OF POLICE AND LEGAL INVESTIGATIONS INTO CONTRACTUAL PRACTICES AT METROPOLITAN AMBULANCE SERVICE

3.2.81 My Special Report No. 49, tabled in Parliament in April 1997, raised many serious concerns in relation to certain contractual and outsourcing arrangements entered into by the Metropolitan Ambulance Service between April 1993 and March 1995.

3.2.82 My Report illustrated that former senior management at the Service throughout this period showed a total disregard for the Government's outsourcing guidelines and normal tendering practices.

3.2.83 Significant deficiencies in contract management were identified for 6 major consultancies and outsourcing arrangements involving tens of millions of dollars. The breadth and consistency of these deficiencies were such that it would have been an oversimplification to suggest that they all could be solely attributed to managerial incompetence. The audit found that senior management at the time had created an environment at the Service which enabled consultancy firms to reap sizeable benefits without challenge. In the case of Griffiths Consulting Pty Ltd, an initial engagement for $45 000, without a tender or contract, was continuously expanded as a result of the advantage gained from the initial arrangement. Total payments to this firm eventually amounted to over $1.5 million.



Auditor-General's Special Report on the Metropolitan Ambulance Service, tabled in the Parliament in April 1997.

3.2.84 The Report also identified that in virtually all cases, including the awarding of a contract to Intergraph Corporation Pty Ltd involving a minimum cost of $30 million over 4 years, key documentation supporting critical management decisions could not be produced by the Service for audit examination.

3.2.85 Shortly after a summary of draft audit findings prepared by my Office was available to the Government, the Minister announced in Parliament that Victoria Police had been asked to investigate all of the issues. The Minister also said that senior counsel had been engaged to determine whether grounds existed for the commencement of action to recover moneys paid to any person or consulting company by the Service during the period 1993 to 1995.

3.2.86 I subsequently included the following comments in my April 1997 Report to Parliament on the above announcements by the Minister:

> "*While recognising the actions initiated by the Minister, the absence of key documentation encountered during the audit is likely to be a significant impediment in the proposed police investigation. If at the conclusion of the police investigation, such proves to be the case, I consider the matters raised in this Report should be investigated in a forum where witnesses are required to give evidence under oath. Such a course of action could determine whether the various contractual arrangements at the Service were carried out in a manner which, at best, involved serious mismanagement or, at worst, constituted corrupt activity. An inquiry of this nature may also be necessary to identify and investigate all inter-relationships between the various parties referred to in this Report as well as to determine if any inappropriate financial benefits or other benefits in kind accrued to any party from such inter-relationships*."

3.2.87 In the following paragraphs, I have set out a summation of the results of the investigation undertaken by Victoria Police and of the legal examination by senior counsel of recovery potential arranged by the Minister. The details presented are based on information provided to my Office by Victoria Police and the Minister.

Police investigation

3.2.88 The police investigation commenced early in April 1997. From that time, a wide range of investigative activities was carried out by the investigation team. These activities encompassed the execution of search warrants, interviews with relevant parties and the obtaining of a substantial number of written statements from potential witnesses.

3.2.89 Regular reports on the progress of activities were compiled by the head of the investigation team.

3.2.90 When the investigation was substantially complete, briefs of evidence were prepared in relation to various suspects for offences identified from the investigation. Because of the unusual nature of a proposed misfeasance charge and the overall circumstances surrounding all proposed criminal charges, Victoria Police sought advice from the Director of Public Prosecutions regarding the sufficiency of evidence to support the envisaged charges. The proposed charges which were linked to particular individuals related to Collusive Tendering, Conspiracy to Defraud, Obtaining Financial Advantage by Deception, Misfeasance in Public Office and Perverting the Course of Justice.

3.2.91 The process of review and examination by the Director of Public Prosecutions was extensive and covered a significant period of time. Throughout this period, regular discussions occurred between the Director of Public Prosecutions and the police investigation team.

3.2.92 At a point in time, the Director of Public Prosecutions viewed the circumstances relating to certain proposed charges to be sufficiently complex and difficult that they should be the subject of "special decision" in terms of the *Public Prosecutions Act* 1994. As a consequence, the matter was also considered by the Chief Crown Prosecutor and the Senior Crown Prosecutor in addition to the Director of Public Prosecutions.

3.2.93 In March 1999, the Director of Public Prosecutions advised the head of the investigation team that, after extensive deliberation, including liaison with senior legal advisers, it was considered that the proposed charges would not offer reasonable prospects of conviction.

3.2.94 Soon after, the then Acting Chief Commissioner of Police wrote to the Minister for Police and Emergency Services and the Secretary, Department of Human Services advising of this outcome.

3.2.95 The Acting Chief Commissioner indicated in the letter that the investigation team did not disagree with the opinion of the Director of Public Prosecutions and accordingly no criminal charges would be laid in relation to the investigation. It was also advised that the Director of Public Prosecutions had acknowledged the complexity of the issues involved and the difficulties faced by police in an investigation of such magnitude and had expressed the opinion that the final advice in no way detracted from the professionalism and thoroughness of the investigation.

3.2.96 After examining the police documentation and becoming aware of the initiatives and measures taken by the investigation team in the pursuit of sufficient information to sustain criminal charges, I can very much appreciate the conclusion reached by the Director of Public Prosecutions on the professionalism and thoroughness of the police work. In this regard, it was carried out within an environment which presented significant difficulties and continuing challenges because of missing key documentation and a lack of reliable or willing witnesses.

Legal and consultancy examinations of recovery potential

3.2.97 This element of the investigatory action initiated by the Government following my April 1997 Report focused on the potential to commence civil action to recover moneys. It involved the engagement of both legal counsel and an external consultant.

3.2.98 In April 1999, the Minister for Health formally advised me of the nature and results of the action taken in this area.

3.2.99 At the time of the request by the Minister in April 1997 for the above police investigation, the Department of Human Services engaged senior counsel to advise whether there were grounds for commencing civil action for the recovery of moneys paid to any person or firm. The initial advice provided to the Department was preliminary in nature as, although it conveyed the view of likely potential for sustaining recovery actions, it also indicated more investigative work was required before a conclusion could be reached that any civil action should be commenced.

3.2.100 As a consequence of this preliminary advice from senior counsel, the Department engaged an experienced financial accountant to carry out the necessary additional investigative tasks. The accountant embarked on an extensive program of investigative work into issues arising from my April 1997 Report to Parliament. A main report was presented to the Department in July 1997 and was supplemented by 2 follow-up reports presented on 29 August and 1 October 1997 and a final report dated 22 December 1998.

3.2.101 The reason for the time gap in reports between October 1997 and December 1998 was the Department determined to await the outcome of the police investigation as any decision taken in respect of criminal action may have been of assistance in reaching decisions on possible civil action. However, by late 1998, the Department was concerned about the operation of the Statute of Limitations and asked the investigating accountant to finalise work at that time.

3.2.102 The accountant's July 1997 report documented deep-seated criticism of the management of particular contractual arrangements at the Metropolitan Ambulance Service during the period covered in my Report from the viewpoints of the integrity of actions by senior management and assessed financial damage caused to the Service. On this latter point, the accountant considered the financial damage to the Service arising from the misleading activity of senior management could be as high as $11 197 000 per annum. The accountant also severely criticised the propriety of the involvement of the particular consultancy firm which played a lead role in the contractual arrangements at the Service and which featured prominently in my parliamentary Report.

3.2.103 The accountant's report provided clear confirmation of the concerns I expressed to Parliament in April 1997. It was publicly released by the Minister earlier this year.

3.2.104 Each of the reports submitted by the accountant was referred by the Department to senior counsel for consideration and advice.

3.2.105 After careful assessment of the circumstances and the progressive reports submitted by the accountant, senior counsel concluded in February 1999 that the costs and risks of suing were too high in relation to the amount at stake. In this regard, overpayments totalling $463 000 to the main consulting firm utilised by the Service were identified as worthy of initiating proceedings for recovery but legal costs were estimated to be at least $250 000. The conclusion reached by senior counsel was supported by the Victorian Government Solicitor.

3.2.106 The legal advice provided to the Department illustrated the difficulty, as experienced in this case, of reaching a commercial decision on whether or not to commence litigation.

My final audit comment on this subject

3.2.107 The concluding comment conveyed to me by the Minister on the above actions was as follows:

> "*The matters raised in the Special Report No. 49 have now been investigated fully from both a criminal and civil perspective. The State Government now considers these matters to have been adequately investigated and does not propose to take any further action.*"

3.2.108 After my examination of the information provided to me in respect of the 2 tiers of investigations, I do not disagree with the above Government decision.

3.2.109 As I became familiar back in 1997 with the absolute seriousness of the circumstances identified by my staff at the Metropolitan Ambulance Service, I was overwhelmed by 2 striking factors: the magnitude of the mismanagement, and the absence of documentation to support key decisions reached on the engagement and remuneration of consultants and the awarding of major contracts. It was these 2 factors which prompted my call for a high-level investigation where witnesses would be required to give evidence under oath in order to determine whether corrupt activity had occurred and to fully examine any inter-relationships between particular parties.

3.2.110 While a judiciary inquiry did not eventuate, I do draw comfort from the fact that senior legal counsel, expert police investigators and an experienced financial accountant formed views of the seriousness and complexity of the situation at the Service which mirrored my own and those of my staff.

3.2.111 The fact that no criminal charges will be laid and no civil proceedings to recover overpayments will be commenced should not be interpreted as lessening the degree of mismanagement by senior Service officials at the time or the extent of the freedom accorded to certain consultants. As I have pointed out in earlier paragraphs, the outcomes in this case can be more attributed to the nature of the circumstances and specific difficulties which particularly impacted on the criminal investigation, namely, the absence of key documentation and the lack of reliable or willing witnesses.

3.2.112 If there is one clear message arising from the unfortunate experiences of this case, it is that the integrity of management actions and decisions in contractual and outsourcing matters must always be transparent and supported by strong probity arrangements. These conditions, which are spelt out in the Government's policy guidelines, are fundamental to ensuring the circumstances identified at the Metropolitan Ambulance Service between 1993 and 1995 are never repeated in this State.

SCHEDULE A
STATUS OF MATTERS RAISED IN PREVIOUS REPORTS

Report	Subject	Status at date of preparation of this Report
	MATTERS RESOLVED OR ACTION COMMENCED	
DEPARTMENT OF HUMAN SERVICES		
Ministerial Portfolios, May 1998, p. 55.	The Department's procedures do not require that a business case be developed when considering the outsourcing of functions or activities. Accordingly, the Department is not in a position to determine whether the most cost efficient and effective option is selected for the provision of services.	The Department has introduced new business rules which require that a business case analysis be prepared for the outsourcing of services which includes a cost benefit analysis.
Ministerial Portfolios, May 1998, p. 56.	The Department needs to establish formalised monitoring procedures covering both service delivery and qualitative issues to ensure adequate accountability over contracts. Such procedures should enable poor performance to be highlighted and appropriately addressed by management.	The Department is reviewing the effectiveness of performance indicators for contracted services. The Department's contestability policy and business rules require each program to undertake a post implementation review of outsourced services which includes the evaluation of outcomes against the initial business case specifications.
Ministerial Portfolios, May 1998, p. 61.	Deficiencies were identified in the content, approval and monitoring of expenditure plans relating to Residents' Amenities Funds.	A working group, set up by the Department to undertake an internal review of the operations of the Residents' Amenities Funds, has submitted a report which includes proposed amended guidelines relating to annual plans for expenditure proposals. The report is being considered by the Disability Services Branch of the Department.
Ministerial Portfolios, May 1998, p. 62.	Vehicle operating expenses are the major item of expenditure from Residents' Amenities Funds. As vehicle costs are rapidly depleting amounts available in the Funds, the Department needs to urgently review the on-going viability of the Funds.	The report of the above working group includes recommendations to improve the funding process and future viability of the Residents' Amenities Funds.
Ministerial Portfolios, May 1998, p. 62.	The Department does not have a systematic process to identify and record asset purchases funded from Residents' Amenities Funds. Accordingly, the Department was unable to assure the safeguarding of the assets or ensure that proceeds on disposal of the assets were returned to eligible persons as required by the *Intellectually Disabled Persons' Services Act* 1986.	The Department has commenced a process for identifying and recording assets purchased from Residents' Amenities Funds.

SCHEDULE B
COMPLETED/INCOMPLETE AUDITS

Entity	Financial year/ period ended	Reporting to Parliament	Financial statements signed by entity	Auditor-General's report signed
COMPLETED AUDITS				
Department of Human Services	30 June 1998	31 Oct. *Financial Management Act* 1994, s.46.	23 Sept. 1998	19 Oct. 1998
HEALTH				
Advanced Dental Technicians Qualifications Board	30 June 1998	" "	9 Sept. 1998	22 Sept. 1998
Ambulance Officers' Training Centre	30 June 1998	" "	9 Sept. 1998	22 Sept. 1998
Alexandra and District Ambulance Service	30 June 1998	" "	16 Oct. 1998	4 Nov. 1998
Ambulance Service Victoria -				
Metropolitan Region	30 June 1998	" "	18 Aug. 1998	2 Sept. 1998
North Eastern Region	30 June 1998	" "	18 Aug. 1998	29 Sept. 1998
North Western Region	30 June 1998	" "	24 Aug. 1998	25 Sept. 1998
South Eastern Region	30 June 1998	" "	18 Sept. 1998	29 Sept. 1998
South Western Region	30 June 1998	" "	10 Aug. 1998	25 Aug. 1998
Western Region	30 June 1998	" "	19 Aug. 1998	28 Sept. 1998
Anti-Cancer Council of Victoria	31 Dec. 1998	" "	8 April 1999	12 April 1999 *(a)*
Chiropractors Registration Board of Victoria	30 June 1998	" "	30 Nov. 1998	2 Dec. 1998
Chiropodists Registration Board of Victoria *(b)*	30 Nov. 1998	" "	13 April 1999	3 May 1999
Dental Board of Victoria	30 Sep. 1998	" "	16 Dec. 1998	24 Dec. 1998
Dental Technicians Licencing Committee	30 June. 1998	" "	9 Sep. 1998	23 Sep. 1998
Healthit Ltd	30 June 1998	31 Oct. *Financial Management Act* 1994, s.53A.	31 Oct. 1998	10 Nov. 1998
Infertility Treatment Authority	30 June 1998	31 Oct. *Financial Management Act* 1994, s.46.	4 Sep. 1998	21 Sept. 1998
Medical Practitioners Board of Victoria	30 Sept. 1998	" "	17 Dec. 1998	24 Dec. 1998

SCHEDULE B
COMPLETED/INCOMPLETE AUDITS - *continued*

Entity	*Financial year/ period ended*	*Reporting to Parliament*	*Financial statements signed by entity*	*Auditor-General's report signed*
		COMPLETED AUDITS - *continued*		
HEALTH - *continued*				
Mental Health Review Board	30 June 1998	31 Oct. *Financial Management Act* 1994, s.46.	30 Sept. 1998	6 Oct. 1998
Nurses Board of Victoria	30 June 1998	" "	27 Aug. 1998	24 Sept. 1998
Optometrists Registration Board of Victoria	30 June 1998	" "	17 Aug. 1998	28 Aug. 1998
Osteopaths Registration Board of Victoria	30 June 1998	" "	9 Oct. 1998	30 Oct. 1998
Pharmacy Board of Victoria	30 June 1998	" "	26 Aug. 1998	16 Sept. 1998
Physiotherapists Registration Board of Victoria	30 June 1998	" "	9 Oct. 1998	23 Oct. 1998
Prince Henry's Institute of Medical Research	31 Dec. 1998	" "	30 Mar. 1999	7 May 1999
Psychologists Registration Board of Victoria	31 Dec. 1997	" "	2 Apr. 1998	12 May 1998
Psychologists Registration Board of Victoria	31 Dec. 1998	" "	24 Mar. 1999	31 Mar. 1999
Psychosurgery Review Board	30 June 1998	" "	30 Sept. 1998	6 Oct. 1998
Public Cemeteries -				
Anderson's Creek Cemetery Trust	31 Dec. 1998	" "	29 Mar. 1999	30 Mar. 1999
Ballaarat General Cemeteries Trust	31 Dec. 1998	" "	1 April 1999	12 April 1999
Bendigo Cemeteries Trust	31 Dec. 1998	" "	29 Mar. 1999	31 Mar. 1999
Cheltenham and Regional Cemeteries Trust	31 Dec. 1998	" "	9 Mar. 1999	24 Mar. 1999
Geelong Cemeteries Trust	31 Dec. 1998	" "	19 Mar. 1999	29 Mar. 1999
Keilor Cemetery Trust	31 Dec. 1998	" "	11 Mar. 1999	26 Mar. 1999
Mildura Cemetery Trust	31 Dec. 1997	" "	31 Mar. 1998	3 July 1998
Preston Cemetery Trust	31 Dec. 1997	" "	15 Sept. 1998	22 Feb. 1999
Templestowe Cemetery Trust	31 Dec. 1998	" "	31 Mar. 1999	1 Apr. 1999

SCHEDULE B
COMPLETED/INCOMPLETE AUDITS - *continued*

Entity	*Financial year/ period ended*	*Reporting to Parliament*	*Financial statements signed by entity*	*Auditor-General's report signed*
		COMPLETED AUDITS - *continued*		
HEALTH - *continued*				
Trustees of the Fawkner Crematorium and Memorial Park	31 Dec. 1998	31 Oct. *Financial Management Act* 1994, s.46.	4 Mar. 1999	23 Mar. 1999
Trustees of the Lilydale Memorial Park and Cemetery	31 Dec. 1998	" "	31 Mar. 1999	6 Apr. 1999
Trustees of the Memorial Park	31 Dec. 1998	" "	6 Apr. 1999	21 Apr. 1999
Trustees of the Necropolis Springvale	31 Dec. 1998	" "	26 Mar. 1999	29 Mar. 1999
Wyndham Cemeteries Trust	31 Dec. 1997	" "	30 Nov. 1998	24 Feb. 1999
Victorian Health Promotion Foundation	30 June 1998	" "	28 Aug. 1998	3 Sept. 1998
PUBLIC HOSPITALS				
Alexandra District Hospital	30 June 1998	" "	20 Aug. 1998	7 Sept. 1998
Alpine Health	30 June 1998	" "	26 Aug. 1998	2 Oct. 1998 *(a)*
Austin and Repatriation Medical Centre	30 June 1998	" "	25 Sept. 1998	28 Oct. 1998 *(a)*
Bairnsdale Regional Health Service	30 June 1998	" "	27 Aug. 1998	3 Sept. 1998
Ballarat Health Services	30 June 1998	" "	27 Aug. 1998	5 Oct. 1998 *(a)*
Barwon Health	30 June 1998	" "	11 Sept. 1998	2 Oct. 1998
Beaufort and Skipton Health Service	30 June 1998	" "	12 Aug. 1998	14 Sept. 1998
Beechworth Hospital, The	30 June 1998	" "	21 Aug. 1998	31 Aug. 1998
Benalla and District Memorial Hospital	30 June 1998	" "	18 Aug. 1998	7 Sept. 1998 *(a)*
Bendigo Health Care Group	30 June 1998	" "	24 Aug. 1998	21 Sept. 1998 *(a)*
Bethlehem Hospital Incorporated	30 June 1998	31 Oct. *Financial Management Act* 1994, s.53A.	24 Aug. 1998	21 Sept. 1998

SCHEDULE B
COMPLETED/INCOMPLETE AUDITS - *continued*

Entity	*Financial year/ period ended*	*Reporting to Parliament*	*Financial statements signed by entity*	*Auditor-General's report signed*
		COMPLETED AUDITS - *continued*		
PUBLIC HOSPITALS - *continued*				
Boort District Hospital	30 June 1998	31 Oct. *Financial Management Act* 1994, s.46.	31 Aug. 1998	15 Sept. 1998
Caritas Christi Hospice Limited	30 June 1998	31 Oct. *Financial Management Act* 1994, s.53A.	23 Sept. 1998	7 Oct. 1998
Casterton Memorial Hospital	30 June 1998	31 Oct. *Financial Management Act* 1994, s.46.	17 Aug. 1998	26 Aug. 1998
Central Wellington Health Service	30 June 1998	" "	17 Aug. 1998	26 Aug. 1998
Cobram District Hospital	30 June 1998	" "	28 July 1998	24 Aug. 1998
Cohuna District Hospital	30 June 1998	" "	8 Sept. 1998	11 Sept. 1998 *(a)*
Colac Community Health Services	30 June 1998	" "	26 Aug. 1998	28 Sept. 1998
Coleraine and District Hospital	30 June 1998	" "	24 Aug. 1998	17 Sept. 1998
Corangamite Regional Hospital Services	30 June 1998	" "	4 Sept. 1998	8 Sept. 1998
Dental Health Services Victoria	30 June 1998	" "	7 Sept. 1998	10 Sept. 1998
Djerriwarrh Health Services	30 June 1998	" "	2 Oct. 1998	23 Oct. 1998
Dunmunkle Health Services	30 June 1998	" "	20 Aug. 1998	1 Sept. 1998
East Grampians Health Service	30 June 1998	" "	24 Aug. 1998	1 Sept. 1998
East Wimmera Health Service	30 June 1998	" "	28 Sept. 1998	29 Sept. 1998
Echuca Regional Health	30 June 1998	" "	24 Aug. 1998	25 Sept. 1998
Edenhope and District Memorial Hospital	30 June 1998	" "	20 Aug. 1998	1 Sept. 1998
Far East Gippsland Health and Support Service	30 June 1998	" "	1 Sept. 1998	25 Sept. 1998
Gippsland Southern Health Service	30 June 1998	" "	21 Aug 1998	2 Sept. 1998

SCHEDULE B
COMPLETED/INCOMPLETE AUDITS - *continued*

Entity	*Financial year/ period ended*	*Reporting to Parliament*	*Financial statements signed by entity*	*Auditor-General's report signed*
COMPLETED AUDITS - *continued*				
PUBLIC HOSPITALS - *continued*				
Goulburn Valley Base Hospital	30 June 1998	31 Oct. *Financial Management Act* 1994, s.46.	7 Sept. 1998	9 Sept. 1998
Hamilton Base Hospital	30 June 1998	" "	14 Aug. 1998	23 Sept. 1998
Hepburn Health Service	30 June 1998	" "	25 Sept. 1998	6 Oct. 1998
Hesse Rural Health Service	30 June 1998	" "	24 Sept. 1998	9 Oct. 1998
Heywood and District Memorial Hospital	30 June 1998	" "	20 Aug. 1998	17 Sept. 1998
Inglewood and Districts Health Service	30 June 1998	" "	1 Sept. 1998	11 Sept. 1998
Inner and Eastern Health Care Network	30 June 1998	" "	21 Aug. 1998	23 Sept. 1998
Kerang and District Hospital	30 June 1998	" "	24 Aug. 1998	31 Aug. 1998
Kilmore and District Hospital	30 June 1998	" "	18 Aug. 1998	15 Sept. 1998
Kooweerup Regional Health Service	30 June 1998	" "	30 Sept. 1998	4 Nov. 1998 *(a)*
Kyabram and District Memorial Community Hospital	30 June 1998	" "	13 Aug. 1998	17 Sept. 1998
Kyneton District Health Service	30 June 1998	" "	10 Sept. 1998	16 Sept. 1998
Latrobe Regional Hospital	30 June 1998	" "	21 Sept. 1998	5 Oct. 1998
Lorne Community Hospital	30 June 1998	" "	29 Sept. 1998	6 Oct. 1998
Maffra District Hospital	30 June 1998	" "	26 Aug. 1998	9 Oct. 1998
Maldon Hospital	30 June 1998	" "	17 Sept. 1998	17 Sept. 1998
Mallee Track Health and Community Service	30 June 1998	" "	17 Sept. 1998	24 Sept. 1998

SCHEDULE B
COMPLETED/INCOMPLETE AUDITS - *continued*

Entity	*Financial year/ period ended*	*Reporting to Parliament*	*Financial statements signed by entity*	*Auditor-General's report signed*
COMPLETED AUDITS - *continued*				
PUBLIC HOSPITALS - *continued*				
Manangatang and District Hospital	30 June 1998	31 Oct. *Financial Management Act* 1994, s.46.	17 Sept. 1998	25 Sept. 1998
Mansfield District Hospital	30 June 1998	" "	27 Aug. 1998	10 Sept. 1998
Maryborough District Health Service	30 June 1998	" "	4 Sept. 1998	29 Sept. 1998
McIvor Health and Community Services	30 June 1998	" "	31 Aug. 1998	2 Sept. 1998
Mercy Public Hospitals Inc.	30 June 1998	31 Oct. *Financial Management Act* 1994, s.53A.	6 Dec. 1998	8 Dec. 1998 *(a)*
Mildura Base Hospital	30 June 1998	31 Oct. *Financial Management Act* 1994, s.46.	31 Aug. 1998	2 Oct. 1998 *(a)*
Mt Alexander Hospital	30 June 1998	" "	27 Aug. 1998	16 Sept. 1998
Nathalia District Hospital	30 June 1998	" "	10 Sept. 1998	28 Sept. 1998
North Western Health Care Network	30 June 1998	" "	30 Sept. 1998	28 Oct. 1998 *(a)*
Numurkah District Health Service	30 June 1998	" "	19 Aug. 1998	22 Sept. 1998
O'Connell Family Centre (Grey Sisters) Inc.	30 June 1998	31 Oct. *Financial Management Act* 1994, s.53A.	23 Sept. 1998	13 Oct. 1998
Omeo District Hospital	30 June 1998	31 Oct. *Financial Management Act* 1994, s.46.	25 Aug. 1998	7 Sept. 1998
Otway Health and Community Services	30 June 1998	" "	24 Sept. 1998	5 Oct. 1998
Peninsula Health Care Network	30 June 1998	" "	24 Aug. 1998	18 Sept. 1998
Penshurst and District Memorial Hospital	30 June 1998	" "	14 Aug. 1998	15 Sept. 1998
Port Fairy Hospital	30 June 1998	" "	25 Aug. 1998	1 Sept. 1998

SCHEDULE B
COMPLETED/INCOMPLETE AUDITS - *continued*

Entity	*Financial year/ period ended*	*Reporting to Parliament*	*Financial statements signed by entity*	*Auditor-General's report signed*
COMPLETED AUDITS - *continued*				
PUBLIC HOSPITALS - *continued*				
Portland and District Hospital	30 June 1998	31 Oct. *Financial Management Act* 1994, s.46.	28 Aug. 1998	31 Aug. 1998
Queen Elizabeth Centre	30 June 1998	" "	14 Sept. 1998	14 Oct. 1998 *(a)*
Robinvale District Hospital and Health Services	30 June 1998	" "	23 Oct. 1998	30 Oct. 1998
Rochester and Elmore District Health Service	30 June 1998	" "	3 Sept. 1998	9 Sept. 1998
Seymour District Memorial Hospital	30 June 1998	" "	9 Sept. 1998	24 Sept. 1998
South Gippsland Hospital	30 June 1998	" "	11 Sept. 1998	21 Sept. 1998
Southern Health Care Network	30 June 1998	" "	22 Aug. 1998	28 Sept. 1998 *(a)*
St Vincent's Hospital (Melbourne) Limited	30 June 1998	31 Oct. *Financial Management Act* 1994, s.53A.	23 Sept. 1998	26 Oct. 1998 *(a)*
Stawell District Hospital	30 June 1998	31 Oct. *Financial Management Act* 1994, s.46.	24 Aug. 1998	27 Aug. 1998
Swan Hill District Hospital	30 June 1998	" "	24 Sept. 1998	28 Sept. 1998
Tallangatta Hospital	30 June 1998	" "	17 Aug. 1998	31 Aug. 1998
Terang and Mortlake Health Service	30 June 1998	" "	26 Aug. 1998	1 Sept. 1998
Timboon and District Healthcare Service	30 June 1998	" "	21 Aug. 1998	17 Sept. 1998
Tweddle Child and Family Health Service	30 June 1998	" "	24 Aug. 1998	4 Sept. 1998
Upper Murray Health and Community Services	30 June 1998	" "	4 Sept. 1998	28 Sept. 1998
Wangaratta District Base Hospital	30 June 1998	" "	24 Aug. 1998	22 Sept. 1998 *(a)*
Warracknabeal District Hospital	30 June 1998	" "	19 Aug. 1998	10 Sept. 1998

SCHEDULE B
COMPLETED/INCOMPLETE AUDITS - *continued*

Entity	*Financial year/ period ended*	*Reporting to Parliament*	*Financial statements signed by entity*	*Auditor-General's report signed*
COMPLETED AUDITS - *continued*				
PUBLIC HOSPITALS - *continued*				
Warrnambool and District Base Hospital	30 June 1998	31 Oct. *Financial Management Act* 1994, s.46.	19 Aug. 1998	17 Sept. 1998
West Gippsland Healthcare Group	30 June 1998	" "	17 Aug. 1998	26 Aug. 1998
West Wimmera Health Service	30 June 1997	" "	7 May 1998	1 June 1998
Wimmera Health Care Group	30 June 1998	" "	21 Aug. 1998	1 Sept. 1998
Wodonga Regional Health Service	30 June 1998	" "	17 Aug. 1998	25 Aug. 1998
Women's and Children's Health Care Network	30 June 1998	" "	27 Aug. 1998	11 Sept. 1998
Wonthaggi and District Hospital	30 June 1998	" "	8 Oct. 1998	24 Dec. 1998 *(a)*
Wycheproof and District Health Service	30 June 1998	" "	4 Sept. 1998	21 Sept. 1998
Yarram and District Health Service	30 June 1998	" "	21 Aug. 1998	31 Aug. 1998
Yarrawonga District Hospital	30 June 1998	" "	11 Sept. 1998	7 Oct. 1998
Yea and District Memorial Hospital	30 June 1998	" "	22 Sept. 1998	24 Sept. 1998
INCOMPLETE AUDITS				
Mildura Cemetery Trust	31 Dec. 1998	31 Oct. *Financial Management Act* 1994, s.46.	Awaiting signed financial statements.	
Preston Cemetery Trust	31 Dec. 1998	" "	" "	
Wyndham Cemetery Trust	31 Dec. 1998	" "	" "	
West Wimmera Health Service	30 June 1998	" "	" "	

(a) Qualified audit report issued.

(b) Entity abolished as at reporting date and reconstituted as the Podiatrists Registration Board of Victoria.

Part 3.3

Infrastructure

KEY FINDINGS

Public transport reform

- The average estimated cost recovery of the public transport train and tram passenger businesses in the 1998-99 financial year will be around 55 per cent, representing a total shortfall of earnings before interest, taxation and abnormal costs of $284 million.

  Paras 3.3.4 to 3.3.9

- In September 1998, the consultant engaged by the Government concluded that the intrastate infrastructure, including track, formation and drainage, structure, bridges, signalling and train control, was basically fit for freight and passenger operating purposes but a maintenance backlog in the order of $23 million was identified, with backlogs identified in all transport corridors.

  Paras 3.3.27 to 3.3.30

Public transport fare evasion and revenue protection

- Transport surveys identified fare evasion on train services of 7.6 per cent on weekdays and 16.9 per cent during weekends, and fare evasion on tram services of 5.8 per cent on weekdays and 10.3 per cent during weekends.

  Paras 3.3.38 to 3.3.58

- In the period from November 1998 to February 1999, around 240 items of automated ticketing system (ATS) equipment, mainly dispensers, were damaged by corrosive liquid attacks at 142 metropolitan rail stations and 39 dispensers were damaged by other means. During this period, the Public Transport Corporation paid $3.4 million to security firms engaged to protect the ATS dispensers. The Corporation has been unable to provide a specific estimate of the loss of fare revenue collections resulting from the non-operation of the ATS equipment.

  Paras 3.3.59 to 3.3.65

- Audit was unable to conduct an analysis of patronage levels due to the inability to rely on the accuracy of information prior to the commissioning of the ATS which occurred in December 1998.

  Paras 3.3.66 to 3.3.71

KEY FINDINGS - *continued*

Melbourne City Link extension project

- The audit analysis of the arrangements associated with the development and operation of the *City end* of the Exhibition Street extension concluded that the State has accepted the construction risk, however, by virtue of the payment of an expected contract sum of $37.5 million by Transurban to the State upon completion and delivery of the *City end* of the extension, the State aims to recoup the total cost of its design, construction and delivery.

  Paras 3.3.89 to 3.3.97

- Under the established arrangements associated with the Exhibition Street extension tollway, Transurban and/or its subsidiary Clepco will bear the risk of reductions in traffic volumes and associated toll revenue brought about by various factors including incorrect traffic flow projections, adverse economic conditions, and changing travel patterns and habits.

  Paras 3.3.112 to 3.3.127

External financial reporting in the local government sector

- Since 1995, there has been a threefold improvement in the timeliness of financial reporting by local government entities, despite the need for these entities to address a number of substantial industry, financial and accounting issues during this time.

  Paras 3.3.139 to 3.3.145

- With the introduction in the 1998-99 financial year of a new performance reporting regime which will be subject to audit, the challenge remains for all local government entities to continue to provide timely information to ratepayers within the established legislative reporting time frames.

  Paras 3.3.139 to 3.3.146 and 3.3.157 to 3.3.158

Maribyrnong Council - operating lease payout

- The City of Maribyrnong will incur total cash outflows of $39 million, comprising a termination payment of $24 million and future interest charges of $15 million, to terminate an onerous leasing arrangement associated with a building constructed as part of the Quay West Project. In essence, the City is committed to a substantial outlay of funds to the year 2012 which will provide no real benefit to ratepayers because of unsound business decisions made in the past in the area of the City's non-core activities.

  Paras 3.3.167 to 3.3.179

- The net sale proceeds to be obtained by the City in relation to the remaining land associated with the former Quay West project will total $2.2 million, which were consistent with the value of the site at the time of its valuation. However, in 1993 the site was revalued downward by $11 million from the cost actually incurred on acquisition.

  Paras 3.3.180 to 3.3.184

KEY FINDINGS - *continued*

Colac Shire Council - acquisition of abattoir

- Based on the latest available management reports, the financial performance of the Colac Shire Council abattoir was improving and generating positive trading outcomes. However, the overall cost to ratepayers of the Council decision to acquire and operate the abattoir is estimated to be around $1 million.

Paras 3.3.185 to 3.3.202

Frauds in local government

- Legislative amendments should be considered for local government entities requiring annual reporting to the responsible Minister and the Auditor-General of all instances of theft, arson, irregularity and frauds similar to those required of other public sector agencies.

Paras 3.3.203 to 3.3.222

Docklands redevelopment

- The Docklands Stadium arrangements require the State to provide trunk infrastructure valued at $61.5 million which will provide benefits for the whole of the Docklands but which is critical for the Stadium, and to provide 7.2 hectares of land. In addition, the State and has accepted certain defined risks in order to facilitate private sector construction, financing and ownership of the Stadium. Ultimately, under the Stadium arrangements the State will receive $33.7 million from the private sector, not including the economic benefit to be derived from the Stadium development and operation.

Paras 3.3.233 to 3.3.251

- To enhance the development prospects of the new Docklands Stadium, as part of the arrangements for the development, the Authority entered into a user agreement with the Australian Football League.

Paras 3.3.243 to 3.3.248

- As part of the arrangements for the Stadium the developer provided finance of $29.1 million to the Authority. However, the Authority did not obtain the required prior formal approval from the Treasurer for the loan, as required under the *Borrowing and Investment Powers Act* 1987.

Paras 3.3.243 to 3.3.244

- The maximum liability to the State for the risks associated with the failure to establish the Stadium developer's preferred rating arrangement or where the State or a government agency constructs or provides financial assistance for the development of certain other venues, is capped in aggregate at an amount of $10 million for all claims for compensation.

Paras 3.3.249 to 3.3.251

3.3.1 The Minister for Planning and Local Government, the Minister for Roads and Ports and the Minister for Transport have responsibility for operations within the Infrastructure sector. These Ministers have collective responsibility for the Department of Infrastructure.

3.3.2 Details of the specific ministerial responsibilities for public bodies within the Infrastructure sector are listed in Table 3.3A. These public bodies, together with the Department of Infrastructure, were subject to audit by the Auditor-General during the 1997-98 financial year.

TABLE 3.3A
MINISTERIAL RESPONSIBILITIES FOR PUBLIC BODIES WITHIN THE INFRASTRUCTURE SECTOR

Ministerial portfolio	*Entities subject to audit*
Planning and Local Government	Architects Registration Board of Victoria
	Building Control Commission
	CityWide Service Solutions Pty Ltd
	Docklands Authority
	Heritage Council
	Melbourne City Link Authority
	Municipal councils (78)
	Plumbing Industry Board
	Prahran Market Pty Ltd
	Regent Management Co
	Regional library corporations (16)
	Urban Land Corporation
Roads and Ports	Roads Corporation
	Marine Board of Victoria
Transport	Public Transport Corporation

3.3.3 Comment on matters of significance arising from the audit of entities within the Infrastructure sector is provided below.

PUBLIC TRANSPORT REFORM

3.3.4 The Public Transport Corporation was established in July 1989 following the merger of the former Metropolitan Transit Authority (trading as The Met) and the former State Transport Authority (trading as V/Line). The Corporation provided public transport services in the Melbourne metropolitan area through a co-ordinated network of trains, trams and buses, and also operated passenger and freight services in rural Victoria on an extensive non-electrified rail network.

3.3.5 My May 1998 *Special Report No. 59, Public Transport Reforms: Moving from a System to a Service,* provided detailed comment on the Government's Transport Reform Program which was introduced in January 1993 to achieve 2 principal objectives, namely, to ensure the long-term viability of public transport in Victoria and to transform the public transport system into a service that is responsive to the needs of its customers.

3.3.6 As part of the reform program, the Public Transport Corporation was divided into 5 business units known as Met Trains, Met Trams, Met Bus, V/Line Passenger and V/Line Freight. Each unit was individually responsible for managing its own service delivery and marketing, finances, human resources and planning. These businesses were supported by 3 commercial services groups including Infrastructure, Rail Vehicle Maintenance and Central Services, the latter providing business support services such as property, training and commercial development. A small *corporate headquarters group* was responsible for policy, standards and strategic direction.

Swanston Trams' services.

3.3.7 Based on external advice, the Government proceeded to corporatise these business units, facilitated through amendments to the *Rail Corporation Act* 1996 which occurred in December 1997 and May 1998. Under the revised legislation, the Government corporatised V/Line Freight Corporation in July 1997 and disaggregated the Public Transport Corporation's passenger services into the following corporatised businesses which became operative in July 1998:

- *Met Train 1 (trading as Bayside Trains)* - incorporating train services to and from Melbourne's northern, western and south-eastern suburbs through a network of 9 rail lines. In addition, this business manages the Stony Point line (diesel-hauled);
- *Met Train 2 (trading as Hillside Trains)* - incorporating train services to and from Melbourne's eastern and north-eastern suburbs. All of this business's train lines are electrified and the business generally does not share its lines with either freight or other passenger trains;
- *Met Tram 1 (trading as Swanston Trams)* - covering the north-western and south-eastern suburbs and the Melbourne central business district. The business operates 17 routes from 4 tram depots;
- *Met Tram 2 (trading as Yarra Trams)* - incorporating a tram service comprising 10 routes from 4 depots, encompassing both the north-eastern and southern suburbs, as well as the central business district; and
- *V/Line Passenger Corporation* - responsible for the provision of a network of integrated train and coach services to towns and cities across regional Victoria. The rail network consists of 1 640 kilometres of track over 5 rail corridors of which 1 403 kilometres are under the control of the V/Line Freight Corporation in country Victoria, and 237 kilometres under the responsibility of Bayside Trains in the metropolitan area.

3.3.8 Concurrently, in July 1998 certain property, rights and liabilities were allocated and staff transferred from the Public Transport Corporation to the above businesses.

3.3.9 Table 3.3B below outlines some key financial statistics from the information memoranda issued to potential bidders in November 1998 for each of the passenger businesses and shows that **the average estimated cost recovery of the businesses in the 1998-99 financial year will be around 55 per cent, representing a shortfall of earnings before interest, taxation and abnormal costs of $284 million.**

TABLE 3.3B
FINANCIAL DETAILS OF THE PASSENGER RAIL BUSINESSES,
1998-99 FINANCIAL YEAR ESTIMATES *(a)*

Business	*Value of allocated net assets*	*Revenue (b)*	*Expenditure (c)*	*Shortfall of earnings*	*Estimated cost recovery*
	($m)	*($m)*	*($m)*	*($m)*	*(%)*
Bayside Trains	138	116.5	(179.0)	(62.5)	65
Hillside Trains	174	80.4	(136.9)	(56.5)	59
Swanston Trams	145	47.8	(91.2)	(43.4)	52
Yarra Trams	152	39.5	(76.9)	(37.4)	51
V/Line Passenger	92	63.3	(147.5)	(84.2)	43
Total	**701**	**347.5**	**(631.5)**	*(d)* **(284.0)**	**55**

(*a*) Information provided by the Department of Treasury and Finance as documented in the information memoranda issued to interested bidders in November 1998.

(*b*) Total revenue projected for the 1998-99 financial year which excludes a base subsidy to be paid by the State to the businesses.

(*c*) Total projected expenditure for the year ended 30 June 1999, excluding interest, taxation and abnormal costs.

(d) The shortfall of earnings does not include a return on capital invested.

3.3.10 Under the reform program, the Government also established the V/Line Freight Corporation in March 1997 and the Victorian Rail Track in April 1997 with both organisations actually commencing trading in July 1997. Victorian Rail Track assumed responsibility for the non-electrified track in Victoria and the related train control and signalling operations, together with the maintenance and management of the related land and infrastructure, and the marketing and negotiation of access to the rail network. In addition, Victorian Rail Track will assume responsibility for the electrified rail network in the metropolitan area, which is to be leased to the Director of Transport. V/Line Freight Corporation was assigned responsibility for the operation of the non-electrified Victorian intra-State rail track.

Privatisation

3.3.11 In August 1997, the Government announced plans to proceed with the privatisation of public transport in Victoria. The Government's objectives for the privatisation program, as advised to potential bidders in November 1998, are as follows:

- to secure a progressive improvement in the quality of services to public transport users in Victoria;
- to continue to provide users with a high level of safety;
- to minimise the long-term costs of public transport to taxpayers;
- to transfer risk to the private sector; and
- to secure a substantial and sustained increase in the number of passengers using the public transport system.

3.3.12 Under the established arrangements, the tender process for the privatisation of each business is to be overseen by the Transport Reform Unit of the Department of Treasury and Finance. Following the issue of information memoranda and other tender documentation in November 1998 to potential bidders, the Department has advised that at the date of the preparation of this Report, it has short-listed bidders for all the businesses and intends to progressively complete the privatisation process during the third quarter of 1999.

3.3.13 Some of the key arrangements proposed to be established by the State as part of the privatisation program, as outlined in the information memoranda and other tender documentation issued to potential bidders, are briefly presented below.

Proposed contractual arrangements for passenger businesses

3.3.14 The core agreement between the Director of Transport on behalf of the State and the successful bidder (the franchisee) for the operation of each business will be the franchise agreement, which *inter alia* will specify minimum service requirements and performance standards, regulate maximum fares, provide for the payment of subsidies and concession fare supplements, and contain incentive and penalty regimes for operational performance, passenger growth and customer satisfaction.

3.3.15 The State intends to sell the assets of the businesses such as rolling stock on an outright basis, and to lease the other infrastructure and network assets to the franchisees for periods of between 10 to 15 years. The infrastructure lease will specify the infrastructure assets that will be leased to the franchisees in order for them to operate their passenger services. In addition, the agreement will specify the franchisees' maintenance, renewal and improvement obligations with respect to the infrastructure.

3.3.16 The Department has advised that it is seeking bids on the basis of the acquisition of new rolling stock for each of the passenger rail franchises. The new rolling stock will be subject to a 15 year lease arrangement under which, at the end of the first franchise period, the State can decide whether to replace the rolling stock at the end of the initial 15 year lease period or continue to lease the rolling stock for a further term after the 15 year lease period. In addition, the prospective franchisees for Bayside Trains and Hillside Trains will also be expected to include in their bids the financial impact of the refurbishment of the existing Comeng rolling stock.

3.3.17 Furthermore, inter-operator agreements will be entered into between the franchisees covering such issues as revenue allocation, management of the contract associated with the automated ticketing system, track access, station access, operating and electrical control systems, and maintenance.

3.3.18 The State has advised prospective franchisees that under the above agreements they will have the opportunity to earn revenue from the following sources:

- *Base subsidy* - a subsidy payable by the State, determined during the bidding process and set out in the franchise agreement;
- *Operational Performance Regime incentives* - financial incentives payable by the State to franchisees where pre-defined levels of operational performance are exceeded;

- *Per passenger incentives* - financial incentives payable by the State to franchisees where pre-defined levels of patronage growth are exceeded;
- *Farebox revenue* - revenue from ticket sales;
- *Concession top-up* - reimbursements payable to the franchisees by the State in respect of tickets sold at concession prices;
- *Other revenue* - revenue earned from ancillary commercial activities such as retailing and advertising; and
- *Access and inter-operator revenue* - revenue earned by franchisees from regulated or contractual access charges payable by third party operators for the use of their assets and facilities or services provided.

Employee considerations

3.3.19 Given that employee-related expenses accounted for 47 per cent of the Public Transport Corporation's operating expenses in the 1997-98 financial year, these costs and labour productivity are likely to represent a significant determinant of the franchisees' financial and operating performance. In view of this fact, the State has advised bidders that they will have the opportunity to choose from a defined pool of existing public transport employees and the State will accept liability for the payment of accrued benefits and redundancy payments associated with employees not offered positions.

3.3.20 The evaluation of all bids by the Department will take into account the expected redundancy costs to be paid by the State under each proposal.

Ownership restrictions

3.3.21 The Department advised the bidders that since the proposed franchises are founded on geographically-based service groups, direct competition between franchisees is unlikely to be a significant driver of business performance. However, in the interests of maintaining comparative competition, there will be limits on cross-ownership of the franchises. In particular, successful bidders for one of the metropolitan tram and train franchises (or anyone who is entitled to more than a 20 per cent interest in, or controls, a metropolitan tram and train franchise) will be prohibited from being entitled to an interest in, or controlling, any part of the other same-mode metropolitan franchise. However, exemptions for passive investors may be made with the Treasurer's prior written approval. **Therefore, there will be no restriction on the ownership of both a tram and metropolitan train franchise, and the V/Line Passenger franchise.**

3.3.22 The State has advised bidders that arrangements will be established to ensure that this ownership restriction is retained through the life of the franchises and that the potential exists for additional competition from third party operators who successfully negotiate access to the train and tram networks.

3.3.23 The State has determined that an entity which is wholly or partially-owned or controlled by any Australian Government or the existing management of the businesses, will be precluded from having an equity stake in any purchasing consortium.

Regulatory environment

3.3.24 As previously mentioned, the franchisees will enter into franchise and infrastructure lease agreements with the Government, through the Director of Public Transport, who will be responsible for managing and monitoring the Government's contracts with the franchisees and ensuring they comply with service standards.

3.3.25 In addition, the Regulator-General will have responsibility for the regulation of third party access to rail infrastructure in accordance with the *Rail Corporations Act* 1996. The Regulator-General's principal role will be to arbitrate access disputes where a third party operator is unable to agree on the terms and conditions of access to rail infrastructure.

3.3.26 **It is audit's intention to provide an analysis in future Reports to the Parliament of the actual arrangements established in relation to the privatisation of each of the passenger businesses once they are completed.**

Privatisation of V/Line Freight Corporation

3.3.27 In February 1999, the Government announced the sale of the first transport business namely, the V/Line Freight Corporation, to a consortium known as Freight Victoria for $163 million. The Government announced that under the sale arrangements, the purchaser will gain ownership of the Corporation's rolling stock and key maintenance facilities, including the South Dynon locomotive workshop and facilities in Geelong, Portland and Wodonga. The associated arrangements are also to include a 15 year renewable infrastructure lease to operate and maintain the non-electrified rail network on behalf of Victorian Rail Track. **An analysis of these arrangements by audit will be provided in a subsequent Report to Parliament.**

Maintenance of intrastate infrastructure

3.3.28 The lease arrangements in relation to the non-electrified intrastate infrastructure provide for Freight Victoria, the purchaser of V/Line Freight Corporation, to maintain the infrastructure in accordance with its own maintenance strategy, subject to the requirements and rights of other users of the system. For instance, Freight Victoria will be required to maintain the track used by the passenger operators to a standard appropriate for carrying passenger trains.

3.3.29 In the 1997-98 financial year, Victorian Rail Track expended $66 million on infrastructure maintenance and have budgeted for a similar amount in the 1998-99 financial year. The Information Memorandum issued to the prospective purchasers of V/Line Freight Corporation in September 1998 stated that the efficient operation and integration of the infrastructure would provide opportunities to extract significant maintenance savings, including the possibility that rail lines carrying only freight may not need to be maintained to the current standard.

3.3.30 As part of the transport privatisation process, the Department of Treasury and Finance engaged an independent engineering consultant to review the condition of rail lines to be utilised by the purchaser, to assess for fitness for purpose and to determine if a maintenance backlog existed. **In September 1998, the consultant concluded that the intrastate infrastructure, including track, formation and drainage, structure, bridges, signalling and train control, was basically fit for freight and passenger operating purposes but a maintenance backlog in the order of $23 million was identified, with backlogs identified in all corridors.**

❒ ***RESPONSE*** *provided by Secretary, Department of Treasury and Finance*

Financial details of the passenger rail businesses

The Department notes that the financial details included in Table 3.3B do not represent the full cost to the State of purchasing passenger rail services. The 1999-2000 State Budget includes an allocation of $832 million for passenger rail services (the comparable figure for 1998-99 was $823 million). Both figures reflect the impact of the accrual budgeting and capital charging reforms introduced in 1998-99, which were designed to capture all costs of service delivery and which resulted in a significant change in the cost of public transport reported in the State's Budgets.

The "financial details" in Table 3.3B, which are excerpts from information provided to bidders for the passenger rail businesses, show a "shortfall of earnings" which is much lower than the budgeted amount for passenger rail services. The main reason for the difference is that no allowance has been made for the cost of the contributed capital which has funded the acquisition of the large asset base used to provide public transport services. The inclusion of opportunity costs of capital in public transport costings stems from the government's implementation of the recommendations of the Victorian Commission of Audit (Recommendations 9.2 and 9.3, Report of the Victorian Commission of Audit Vol. II, p.148).

A discussion of issues affecting the cost of rail services under government, and eventually private, ownership can be found in the State's 1998-99 Budget (Paper II, pp.148-150).

Maintenance of intrastate infrastructure

The consultant's report stated that "the great majority of the country lines in Victoria are in reasonable condition, and are fit for purposes". A number of passenger lines were identified as needing "planned investment strategies ... with respect to maintaining line speeds".

The engineering report was made available to bidders. Consultants advised that sale of rail networks with maintenance backlogs was in accordance with international practice.

PUBLIC TRANSPORT FARE EVASION AND REVENUE PROTECTION

3.3.31 The May 1997 *Report on Ministerial Portfolios* to the Parliament provided comment on the revenue protection activities undertaken by the Public Transport Corporation and the level of system patronage.

3.3.32 Specifically, in that Report audit commented on the reforms introduced by the Government in January 1993, which were specifically designed to reduce the long-term costs of the public transport system through the implementation of a range of initiatives extending across the whole system. Fare evasion, which was estimated by the Corporation at that time to cost taxpayers between $10 million and $30 million each year, and full-time staffing of low patronage railway stations, were cited as major impediments to the Corporation improving its cost recovery performance. Consequently, a key initiative of the reform program aimed at addressing these impediments was the introduction of an automated ticketing system (ATS) which in particular the Corporation estimated would reduce fare evasion by $11 million over the period January 1993 to December 1995.

3.3.33 That Report also highlighted that audit was unable to determine the effectiveness of the Corporation's revenue protection strategies due to the absence of regular surveys of fare irregularities on each mode of transport as a means of monitoring the extent of fare evasion. In response to the audit findings, the Corporation indicated that following a period of customer familiarity with the ATS, the Corporation would implement effective revenue protection measures.

3.3.34 Furthermore, the Auditor-General's November 1998 *Special Report No. 59: Automating Fare Collection - A Major initiative in public transport* conveyed the results of 2 market surveys conducted by audit, with specialist assistance, of a representative sample of public transport users, in May and August 1998 to ascertain the views of the community on the ATS. The results indicated that many respondents reported that the ATS dispensers were either always, frequently or sometimes out of order, or that ATS validating machines were not operative. In addition, the latter survey determined that 15 per cent of respondents, whose last journey was by tram, had not purchased a ticket representing an annual estimated revenue loss to the Corporation of at least $8 million in relation to fares collected on the tram network.

3.3.35 The following paragraphs provide an update on the recorded levels of system patronage and fare evasion on the metropolitan train and tram networks, together with revenue protection strategies and revenue allocation processes proposed to be adopted as part of the privatisation of the passenger transport businesses.

Revenue protection strategies

3.3.36 From July 1998, primary responsibility for the prevention and detection of fare evasion through the implementation of revenue protection strategies was transferred from the Corporation to the passenger transport businesses, namely, Bayside Trains, Hillside Trains, Swanston Trams and Yarra Trams. However, the Corporation remained responsible for the management of the State's obligations associated with the contractual arrangements with a private consortium for the commissioning and operation of the ATS.

3.3.37 The major fare evasion infringements confronting the passenger transport businesses relate to:

- travelling without a ticket;
- failing to validate a ticket;
- travelling with an invalid ticket;
- purchasing a concession ticket without a valid concession entitlement; and
- using a fraudulent ticket or illegally tampering with a ticket.

Trains

3.3.38 In November 1998, the Department of Treasury and Finance circulated information memoranda to the potential purchasers of the train businesses. These documents stated that the implementation of improved revenue protection measures, which would require increased operational and capital expenditure, would be likely to derive a considerable financial return.

3.3.39 The prospective purchasers were also advised that prior to the installation of the ATS, the results of surveys conducted by consultants engaged by the Corporation in March 1994 indicated that the average fare evasion rate on the train network was around 8 per cent, with the rate varying from 4 per cent for the morning peak period on weekdays to 18 per cent on weekends. These results suggested a strong correlation between low traffic concentration and the level of fare evasion possibly due to the concentration of revenue protection measures during the peak time periods.

3.3.40 The Department also indicated that as part of the operation of the ATS, the train businesses have developed a number of revenue protection strategies to influence the current public culture in relation to fare evasion which was symptomatic of a public transport system characterised by a "light handed approach" to addressing revenue protection. These measures have included:

- improved public education and information regarding tickets and the penalties for fare evasion;
- enhanced ticket availability, together with the improved reliability of the ATS and the gradual elimination of all non-ATS tickets;
- the operation of ATS barriers at 20 of the "premium" train stations, including all central business district stations, which account for 56 per cent of total passenger loadings and unloadings, which require passengers to activate and proceed through barriers by inserting a valid ticket; and

- regular station platform "blitzes" and on-board ticket checks by customer service employees and the undertaking of various customer service roles, such as providing a security presence and assisting with special event travel. In addition, in response to an increase in the number of concession tickets sold and subsequent concerns raised by the Minister for Transport in December 1998, the customer service employees commenced monitoring the validity of concession tickets purchased by commuters.

Automated Ticketing System barrier gates at Flinders Street Station.

3.3.41 **The prospective purchasers were also advised that the best estimate of the current fare evasion level on trains in Melbourne is 10 per cent** and that the successful purchasers of the train businesses could potentially derive a positive net present value if they fund the installation of additional ATS barriers at the remaining "premium" stations and the deployment of a greater number of customer service employees staff. The Department's cost-benefit analysis assumed an ongoing level of fare evasion of 3 per cent.

3.3.42 Documentation provided by the current management of the train businesses showing the results of recent surveys, conducted after the implementation of the ATS, indicated a reduction in the level of fare evasion. The results were as follows:

- **Bayside Trains** - Survey conducted during July and August 1998, showing an average fare evasion rate of 7 per cent, ranging from an average of 6.5 per cent on weekdays to 9.5 per cent on weekends; and
- **Hillside Trains** - Survey conducted during July and August 1998, recording an average fare evasion rate of 7 per cent, ranging from an average of 5.6 per cent on weekdays to 10 per cent on weekends.

Trams

3.3.43 **In November 1998**, the Department advised the prospective purchasers of the tram businesses that although little reliable information existed on the historic levels of fare evasion, a **conservative management estimate of fare evasion was approximately 15 per cent, representing a potential for overall fare revenue growth of $10.9 million** through the implementation of effective revenue protection strategies such as a marketing campaign concerning evasion and an increase in the number of customer service employees. The Department also advised of the following major fare irregularities:

- ticket not obtained due to ATS-related issues and passenger abuse of the "honour" system (i.e. non-validation of MetCard tickets);
- validity and misuse of concessions; and
- over-riding on short-trip tickets.

3.3.44 The significant levels of fare evasion on trams is partly due to the operation of the trams as an "open system" whereby passengers can board and exit vehicles without passing through a barrier or interacting with a driver. While tickets purchased on trams are automatically validated, reliance is placed on passengers to validate pre-purchased tickets.

3.3.45 Audit was advised that following the implementation of the ATS, the tram businesses initially adopted an educational and customer-focused approach to revenue protection. In particular, they had chosen not to fine passengers identified as travelling without a valid ticket during the period in which the ATS dispensers and validating machines were being installed, and in the period until the equipment was demonstrated to operate reliably. Subsequently, commencing in mid-1998, roving uniformed customer service employees commenced issuing warnings to offenders and logged warnings issued on a database, with action taken against repeat offenders. However, a critical element of the fare evasion remained which was the ability of fare evaders to leave the tram or validate previously unvalidated tickets when uniformed customer service employees boarded the tram.

3.3.46 By November 1998, Swanston Trams had identified an increasing level of fare irregularities occurring on its trams, as detailed in Table 3.3C below.

TABLE 3.3C
SWANSTON TRAM TICKET IRREGULARITIES,
JULY 1998 TO NOVEMBER 1998
(per cent)

Ticket irregularity	*July 1998*	*Aug. 1998*	*Sept. 1998*	*Oct. 1998*	*Nov. 1998*
Passengers detected with no tickets	4.7	6.0	7.2	7.3	8.0
Passengers directed to validate tickets	3.9	4.7	5.0	4.8	5.4
Other offences	2.8	2.4	2.1	2.0	2.2
Total	**11.4**	**13.1**	**14.3**	**14.1**	**15.6**

3.3.47 Yarra Trams also indicated that the level of fare evasion in 1997-98 was likely to be close to 15 per cent, with a high proportion directly attributed to travel within the central business district. During special events, fare evasion was estimated to be as high as 40 per cent, due to the inability of staff to check tickets on crowded trams travelling short distances.

3.3.48 In response to the increasing level of fare irregularities, in October 1998, Yarra Trams adopted a revised "Revenue Protection Action Plan" which established a targeted fare evasion rate of 2 per cent by the year 2001. Under the plan, the existing 47 customer service employees, together with the recruitment of an additional 20 personnel in January 1999, adopted a strategy of wearing plain clothes to assist the detection of fare evaders, complemented by the following key initiatives:

- the commencement of information campaigns to encourage the pre-purchase of tickets from retail outlets;
- a minimum checking rate of 3 per cent of all passengers on normal services, with higher rates set for special events;
- the measurement of the effectiveness of each customer service employee in terms of the number of passengers checked and the amount of infringement notices raised; and
- the provision of improved communication facilities between roving customer service employees and their respective depots to enable the immediate identification of offenders by way of a search of electoral rolls and telephone directories.

3.3.49 Swanston Trams formally amended its revenue protection strategy in December 1998 with the introduction of plain-clothed customer service employees and the recruitment of an additional 30 customer service employees, specifically selected for their aptitude and previous experience in law enforcement roles. In addition, the system of issuing warnings ceased, except in cases where passengers suffered from physical limitations or displayed genuine unfamiliarity with the ATS.

3.3.50 Information collected by the customer service employees on the services of both tram businesses suggested that the incidence of irregularities decreased significantly. Swanston Trams reported that the percentage of passengers having no ticket decreased to 3 per cent in March 1999 and the percentage of passengers directed to validate their pre-purchased tickets declined to less than one per cent. The number of irregularities detected by the customer service employees employed by Yarra Trams was also consistently reported at around the 3 per cent level. In addition, Yarra Trams has advised that recent statistics collected during 1999 suggest that the rate of fare evasion by passengers attending special events has declined to between 10 and 20 per cent.

3.3.51 However, **in more recent campaigns undertaken by Yarra Trams using large groups of customer service employees who prevented the majority of passengers from disembarking without a valid ticket have disclosed an average fare evasion rate of 8 per cent**. The number of irregularities detected in such campaigns are detailed in Table 3.3D below.

TABLE 3.3D
YARRA TRAMS FARE EVASION SURVEY RESULTS, JANUARY 1999 TO FEBRUARY 1999
(percentage)

Tram route	*Date of campaign*	*Rate of fare evasion*
70 *(a)*	11 February 1999	5.96
70	13 February 1999	9.77
96 *(b)*	29 January 1999	13.04
96	18 February 1999	7.25
96	21 February 1999	8.43
	Average *(c)*	**8.05**

(a) Route 70 - Wattle Park to Princes Bridge terminus.

(*b*) Route 96 - East Brunswick to St Kilda Beach.

(c) Weighted average based on the total offences detected compared with the number of passengers checked.

Central estimates of fare evasion

3.3.52 At the time of the issue of the information memoranda to the prospective purchasers of the train and tram businesses, the Department also advised that it would carry out surveys to assess the current levels of fare evasion with the intention of providing the results to the short-listed bidders of the businesses by the final stages of the privatisation process. The Department engaged a firm of consultants to undertake the survey in 1998 on both the train and tram network.

Trains

3.3.53 In order to determine the level of fare evasion and a profile of the typical fare evader, surveys were conducted on both the Bayside Trains' and Hillside Trains' services. The consultants, in conjunction with customer service employees from both train operators, surveyed passengers disembarking from trains travelling from the city on 4 lines (2 lines per operator). The surveys were conducted on both weekdays and weekends and during peak and off-peak periods during November and December 1998.

3.3.54 **The surveys identified an average level of fare evasion on train services of 8.9 per cent**, **comprising a rate of 7.6 per cent on weekdays and 16.9 per cent during weekends**. Table 3.3E outlines the results per train line included in the survey.

TABLE 3.3E
TRAIN SERVICE TICKET IRREGULARITIES,
NOVEMBER to DECEMBER 1998 *(a)*
(per cent)

Train line surveyed	*Weekday*	*Weekend*	*Total*
Broadmeadows line	5.9	16.6	7.3
Frankston line	8.9	16.7	10.1
Bayside Trains average	**7.7**	**16.7**	**9.0**
Epping line	9.4	17.9	10.6
Belgrave/Lilydale line	6.7	17.0	7.8
Hillside Trains average	**7.5**	**17.4**	**8.6**
Overall average *(b)*	**7.6**	**16.9**	**8.9**

(a) The results of the surveys are reported with a 90 per cent confidence level and are correct to within a range of less than, or greater than, 0.2 per cent.

(b) Weighted average based on the total offences detected compared with the number of passengers checked.

3.3.55 The survey findings also indicated that 59 per cent of the offenders were not in possession of a ticket, with 16 per cent asserting that the ATS dispensers were not working or would not accept money and 35 per cent stating that they had not purchased a ticket as they were running late for their travel destination. The survey results established that the majority of evaders were male, with more than 45 per cent aged between 15 to 24 years.

Trams

3.3.56 In May 1999, the Department received a draft report from a consultant it engaged outlining the preliminary results of surveys conducted on the tram routes of both Swanston Trams and Yarra Trams in February 1999. These surveys were conducted on 4 tram routes selected by the tram operators between 7.00 a.m. and 4.00 p.m on weekdays, and between 2.00 p.m. and 7.00 p.m. on weekends for Yarra Tram services, and between 7.00 a.m. and 4.00 p.m. on weekends for Swanston Trams. These time periods were chosen as they were considered to be well patronised and as such were more susceptible to higher levels of fare evasion. Table 3.3F outlines the results of these surveys.

TABLE 3.3F
TRAM TICKET IRREGULARITIES,
FEBRUARY 1999 *(a)*
(per cent)

Tram line surveyed	*Weekday*	*Weekend*	*Total*
Route 70 *(b)*	5.1	9.1	6.2
Route 96 *(c)*	6.7	8.2	7.2
Yarra Trams average	**6.2**	**8.5**	**6.9**
Route 19 *(d)*	4.7	11.8	6.0
Route 6 *(e)*	6.7	14.8	8.8
Swanston Trams average	**5.4**	**13.3**	7.1
Overall average *(f)*	**5.8**	**10.3**	**7.0**

(a) The results of the surveys are reported at a 90 per cent confidence level and are correct to within a range of less than, or greater than, 0.4 per cent.

(b) Route 70 - Wattle Park to Princes Bridge terminus.

(c) Route 96 - East Brunswick to St Kilda Beach.

(d) Route 19 - North Coburg to Flinders Street City terminus.

(e) Route 6 - Glen Iris to Melbourne University terminus.

(f) Weighted average based on the total offences detected compared with the number of passengers checked.

3.3.57 **As indicated in the above table, the survey results identified an overall fare evasion rate of 6.9 per cent for Yarra Trams and 7.1 per cent for Swanston Trams.** The surveys disclosed slightly higher levels of fare evasion compared with the results provided by the tram operators based on data collected by customer service employees during the 1998-99 financial year, which identified an overall level of fare evasion on the tram system of 5 per cent. The surveys conducted by the consultant produced higher fare evasion rates as customer service employees were in larger groups enabling more passengers to be checked.

Fare evasion targets following privatisation

3.3.58 Following the privatisation of the train and tram businesses, it is planned that the purchasers, including the Department of Infrastructure on behalf of private bus operators, will be required to enter into agreements to keep fare evasion below an agreed level. As at the date of the preparation of this Report, the Department intends to establish a benchmark level of 8 per cent for the tram operators and 10 per cent for the train operators. The actual level of fare evasion will be monitored by the Department of Infrastructure through periodic surveys and the failure to achieve the benchmark will result in the relevant operator making a payment to the other affected operators.

Impact of criminal damage to ATS dispensers

3.3.59 In early November 1998, the operators of the train businesses faced severe disruption in the availability of the ATS dispensers following a spate of crimes which exacerbated the risk of fare evasion.

3.3.60 At that time, the train businesses were advised that 8 ATS dispensers at 7 metropolitan train stations in the eastern suburbs had been damaged during attempts to illegally remove the cash collections held within the equipment. The offenders had used a corrosive liquid to damage the electronics of the equipment, triggering the discharge of money and rendering the equipment inoperative, requiring their withdrawal from service for major repairs.

3.3.61 The damage to equipment escalated over a period of 2 weeks after the initial wilful damage was reported until 70 machines were out of service. In response, the Corporation in conjunction with the private consortium, responsible for the installation and operation of the ATS, devised modifications to the machines which rendered the use of the corrosive liquid ineffective. The consortium also appointed a security firm to initially guard machines located at 9 major suburban stations and to provide mobile security services at unstaffed stations on one particular train line. However, the attacks continued as perpetrators became aware that the intermittent security presence provided opportunities to access the equipment.

Automated Ticketing System dispensers located at Flinders Street Station.

3.3.62 In response, in late December 1998 the Corporation engaged a security firm to provide both security guards at selected stations and roving security services to cover other stations between the hours of 9 p.m. and 5 a.m. The timing of the attacks again shifted to those times when perpetrators were aware that there would be no security presence. As a consequence, the Corporation immediately engaged security services to provide 24 hour protection, initially at 97 train stations and then increasing to over 200 stations by February 1999. During January 1999, 137 machines were out of service and every metropolitan train line was affected by the incidence of offence, however, the deployment of such security resulted in a rapid reduction in these offences. All damaged machines were back in service by the end of February 1999 and no security guards have been employed since that date.

3.3.63 **In the period from November 1998 to February 1999, items of ATS equipment totalling 243, mainly dispensers, were damaged by corrosive liquid attacks at 142 metropolitan rail stations and 39 dispensers were damaged by other means. During this period the Corporation paid $3.4 million to security firms engaged to protect the ATS dispensers. In addition, at the date of the preparation of this Report, the Corporation has been unable to provide a specific estimate of the loss of fare revenue collections resulting from the non-operation of the ATS equipment.**

3.3.64 At the date of the preparation of this Report, the Corporation has not sought compensation from the consortium for the financial impact of the non-availability of the ATS dispensers or for costs it incurred for the provision of security services. The consortium has also not lodged a claim with the Corporation for the costs it has incurred for the modification of the ATS dispensers.

3.3.65 The agreement between the Corporation and the consortium for the ATS states that the loss of cash collections from ATS dispensers is to be borne by the latter. However, the agreement also states that costs incurred due to vandalism are initially to be met by the consortium to a maximum of $2 million, with related costs in excess of this amount shared equally with the Corporation.

Patronage and revenue levels

3.3.66 My May 1998 *Report on Ministerial Portfolios* commented on the incompleteness of information retained by the Corporation regarding metropolitan train patronage. In response to that Report, the Corporation agreed with audit's recommendation for the finalisation of a method of measuring patronage on the metropolitan rail network, which in the past accounted for around half of the Corporation's overall patronage level, as a means of monitoring fare evasion. The Corporation also stated that the ATS was expected to provide accurate statistical data on patronage.

3.3.67 **However, audit has been unable to conduct an analysis of patronage levels as a result of the following issues, which were identified by management of the train businesses:**

- the inability to rely on the accuracy of information provided by the consortium prior to the commissioning of the ATS which occurred in December 1998; and
- the number of non-MetCard ticket-holding passengers using open bypass gates, which do not provide a physical barrier to entry or exit, at stations is unknown.

3.3.68 In response to these difficulties, overhead counters have recently been installed above the barrier gates in all City Loop stations in order to provide a facility for estimating the number of train passengers.

3.3.69 In relation to the measurement of tram patronage, Swanston Trams advised that following the introduction of the ATS, patronage surveys on its services had ceased in June 1998. The organisation currently relies on the Department of Treasury and Finance survey data in the estimation of tram patronage and expects to continue this practice in the future. Yarra Trams has commenced conducting surveys estimating the indicative patronage figures on a route and timeframe basis.

3.3.70 Table 3.3G illustrates the revenue levels which relates to both metropolitan and V/Line services, for the period July 1995 to January 1999.

TABLE 3.3G
REVENUE LEVELS, JULY 1995 TO JANUARY 1999 *(a)*
($million)

	1995-96	*1996-97*	*1997-98*	*July 1997 to Jan. 1998*	*July 1998 to Jan. 1999*
Revenue	238.9	249.8	251.8	140.9	142.7

(a) Relates to Bayside Trains, Hillside Trains, Swanston Trams, Yarra Trams and V/Line Passenger services.

3.3.71 The audit analysis revealed that revenue levels increased by approximately 4 per cent in the 1996-97 financial year, compared with an increase of less than 1 per cent in the 1997-98 financial year and 1.3 per cent in the 7 months ending January 1999. The Corporation attributed the decline in the growth of revenue to the effect of a freeze on fares in the 1997-98 financial year, the privatisation of the Met Bus business unit in April 1998 and an increased level of industrial disputation within the Corporation.

Revenue allocation

3.3.72 Currently, all revenue earned on multi-modal MetCard tickets is pooled and allocated by the Corporation across the passenger rail businesses and the bus system based on estimated usage as determined by customer surveys. The reliance on surveys for the allocation of revenue is due to the inability of the industry to rely on the information produced by the ATS as passengers are failing to diligently re-validate their tickets between modes of transport and the ATS is unable to measure the distance travelled on trams and buses. According to the Department, these limitations were consistent with the fact that the ATS was designed many years before privatisation of a multi-franchise system was planned.

3.3.73 A proposed revenue clearing house will oversee the management of the surveys and the allocation of the revenue to the train and tram businesses. Currently, the aggregate revenue for the MetCard tickets is allocated as follows:

- revenue from travel on the service of one operator, excluding bus services, is allocated to that operator;
- revenue from travel on bus services is retained by the Corporation; and
- revenue from travel on the services of more than one operator or more than one mode of transport is apportioned between the operators based on the respective distance travelled on each operator's services.

3.3.74 In the near future, revenue from travel on bus services will be allocated to the Department of Infrastructure.

3.3.75 The Department of Treasury and Finance eventually intends to transfer ownership of the revenue clearing house to the successful purchasers of the train and tram businesses and the Department of Infrastructure in respect of bus operations. In addition, it is proposed that the State's obligations under the agreement with the consortium for the ATS will be assigned by the Corporation to the revenue clearing house.

❒ ***RESPONSE*** *provided by Secretary, Department of Treasury and Finance*

Central estimates of fare evasion

In relation to the section on the "central estimates of fare evasion" regarding trains, it should be noted that the PTC has advised that these surveys were conducted during the period in which a significant number of rail station ticket vending machines were out of service due to corrosive liquid attacks. Rail station ticket vending machine availability has improved markedly from that period.

Revenue allocation

In relation to the discussions on "revenue allocation", attention is drawn to paragraph 9.68 of the Auditor-General's "Special Report No. 59: Automated fare collection", November 1998 where it was noted that the OneLink system was conceived in a manner which reflected "management by the PTC in a public ownership context, rather than by a number of separate (private sector) operators". In particular, because it does not measure travel distances for individual tram and bus journeys, there are inherent limitations on the usefulness of ATC data for revenue allocation purposes. For this reason, in order to develop a commercial revenue allocation system, the Government has determined that Metcard revenue should be allocated across passenger rail businesses on the basis of customer surveys.

MELBOURNE CITY LINK - EXHIBITION STREET EXTENSION

3.3.76 The May 1996 *Report on Ministerial Portfolios* and subsequent Reports to the Parliament have provided a detailed analysis of the highly complex arrangements established between the Government and Transurban City Link Limited (Transurban), now a publicly-listed company, for the financing, construction and operation of the Melbourne City Link.

Melbourne City Link project

3.3.77 The Melbourne City Link project represents one of the largest infrastructure projects ever undertaken in Australia and has an estimated total cost of around $2 billion. The project covers approximately 22 kilometres of road, tunnel and bridge works and involves the linking of 3 of Melbourne's most important freeways, namely, the South Eastern, West Gate and Tullamarine Freeways, together with the upgrading of parts of the South Eastern and the Tullamarine Freeways. The key elements of the development include:

- *Southern Link* - 8 kilometres of freeway connecting the West Gate Freeway east of Kings Way to the South Eastern Freeway, and involving the construction of 2 tunnels under the Kings Domain and the Yarra River; and
- *Western Link* - 13 kilometres of new and upgraded freeway-standard roadway, connecting the Tullamarine Freeway to the West Gate Freeway, via a new elevated roadway and a bridge over the Yarra River.

3.3.78 **While the estimated completion dates for the Western and Southern Links were initially assessed by Transurban to be April 1999 and December 1999 respectively, at the date of preparation of this Report the revised completion dates were expected by the company to be late May 1999 for the Western Link and late August 1999 for the Southern Link.**

3.3.79 As outlined in the previous Reports to the Parliament, the primary contractual document establishing the basis upon which the Melbourne City Link project is to proceed is the Concession Deed entered into between the Government and Transurban in October 1995. In addition, the *Melbourne City Link Act* 1995 which incorporated the Concession Deed and was passed by the Parliament in December 1995, provided the Melbourne City Link Authority with certain powers in relation to land and roads affected by the project, and empowered the charging and collection of tolls on the City Link.

3.3.80 Under the established arrangements, once the City Link is completed, Transurban will operate the roadway as a public tollway for an estimated period of 34 years, with toll revenues collected from motorists to be mainly applied towards the cost of its construction, operation and maintenance, with a return on investment available for the investors in the project. At the end of the specified period, ownership of the City Link will revert to the State at no cost and in a fully maintained condition.

3.3.81 A detailed audit analysis of the allocation of key project risks and responsibilities between the relevant parties revealed that, **while certain project responsibilities and risks were assumed by the State, substantial risks and exposures were also transferred to Transurban and users of the City Link.**

3.3.82 In particular, the State has accepted certain obligations, mainly relating to the maintenance of the current overall operating environment for the project and has undertaken to implement certain traffic management measures involving specific changes to the existing road network in the vicinity of the Link (known as *Agreed Traffic Management Measures)*, to enable the most efficient use of the overall road network and provide benefits to the local communities. Furthermore, the Government **may** implement future traffic enhancement measures over the life of the project which could assist Transurban in enhancing the revenues of the project. However, any revenues generated by these additional traffic management measures will be shared between the State and Transurban.

3.3.83 As stated in the May 1996 *Report on Ministerial Portfolios*, **while the users of the City Link via toll payments will, in substance, be the financiers of the project, Transurban has accepted substantial obligations associated with the delivery and operation of the City Link, including traffic and revenue risks. The government decision to establish the City Link as a toll road was not supported by a financial model which compared project costings on the basis of private sector financing versus government borrowings.**

Exhibition Street Extension project

3.3.84 Following the Government's announcement in May 1995 that Transurban was selected as the preferred bidder to undertake the City Link project, there was renewed interest in the development of a connection between the south-east sector of the Melbourne central activities district and Batman Avenue. Consequently, in July 1995, the Government's Sports Precinct and Jolimont Traffic Management Review Committee was established to examine the opportunities provided by the City Link project to enhance the traffic management arrangements in the precinct bounded by the south-east of the central activities district, Swanston Street, the Yarra River and Punt Road. However, as the State was involved in extensive negotiations with Transurban to finalise the contractual arrangements for the City Link, a change in the project scope at that time, as envisaged by the proposed new road connection, would have delayed the finalisation of these negotiations. Consequently, consideration of the matter was deferred until these negotiations were completed, which occurred in March 1996.

3.3.85 Various deliberations and considerations subsequent to the finalisation of the above negotiations associated with the City Link project, which were outlined in the October 1997 *Report on the Government's Annual Financial Statement, 1996-97*, led to an in-principle decision by the Government in late 1996 to proceed with the Exhibition Street Extension project. Consequently, in June 1997, the *Melbourne City Link (Further Amendment) Act* 1997 was enacted to facilitate the construction and operation of the project and, at that time, the Melbourne City Link Authority issued a formal notice to Transurban under the terms of the Melbourne City Link Concession Deed, advising the company of the changes required to facilitate the efficient integration of the Exhibition Street Extension with City Link. Furthermore, the Minister for Planning and Local Government formally announced that the State Government would proceed with the extension of Exhibition Street south-east of Melbourne's central authority district in 2 distinct parts, including:

- *Section 1* (known as the *Punt Road end*), comprising the works on the current City Link project area from Burnley to Batman Avenue, east of Swan Street. This section would be developed by Transurban for inclusion in the existing City Link project; and
- *Section 2* (known as the *City end*), comprising new works outside the current City Link project area from Section 1, along Batman Avenue, the Swan Street/Batman Avenue intersection and along a new alignment and structure over the railyards to Flinders Street. This section would be operated by Transurban, or another private sector operator, on the same basis as the existing City Link project. However, the State would be responsible for the design and construction of this section, with the operator required to make a financial contribution to the State for its design, construction and delivery.

Exhibition Street Extension project - Diagramatic representation.

3.3.86 It was considered necessary to separate the development of the extension project into the 2 distinct sections because the *Punt Road end* of the project was to be developed on City Link project land, with the existing Concession Deed contemplating such an extension, whereas the *City end* of the project was to be developed on land outside the existing project area. In addition, as the extension traversed the Jolimont railyards and access to the land could be hindered by concurrent works associated with both the Jolimont Rail Rationalisation Program and the development of Federation Square, it was decided that the *City end* of the extension project would be best managed by the State.

3.3.87 The Minister for Planning and Local Government identified that the extension would complement the proposed development of Federation Square and would facilitate the development of new parkland along the riverbank, with enhanced pedestrian links from the south edge of the city and the re-alignment of a tram link from Swan Street to Flinders Street, partly along the extension. As the new road connection was considered to be an essential component of the Federation Square project (which is a joint initiative of the Melbourne City Council and the State), it was proposed that the Council would be involved in the urban design and traffic management aspects of the extension project.

3.3.88 Audit undertook an analysis of the arrangements established between the State and other parties for the delivery and operation of the Exhibition Street Extension project. Below is an outline of these arrangements, including the allocation of key risks and responsibilities associated with the project between the respective parties.

"City end" of development

3.3.89 Following the Government's decision to proceed with the Exhibition Street Extension project on the basis that the State would be responsible for the design and construction of the *City end* of the extension, in May 1997 VicRoads, acting as project manager for the Melbourne City Link Authority, sought expressions of interest from interested parties for the design and construction of that component of the project. This process resulted in the receipt of 7 expressions of interest and, subsequently, in June 1997 VicRoads issued a functional design and specification brief to these pre-registered tenderers to assist in their preparation of the bids. The brief provided for the design and construction of a 4 lane divided arterial road covering a distance of 1.3 kilometres, extending south from the existing Flinders Street and Exhibition Street intersection to Batman Avenue, and including a new bridge and road alignment over the Jolimont Rail Yards and upgrade works at Batman Avenue to facilitate the integration of the extension project with the Melbourne City Link project.

3.3.90 In August 1997, VicRoads received bids from 6 of the pre-registered tenderers, with proposed contract sums ranging between $18.8 million and $24 million. The proposals were subsequently subjected to an assessment process involving an evaluation team from VicRoads. Key stakeholders, including the Melbourne City Council, the Melbourne City Link Authority, the Department of Infrastructure and its Office of Major Projects, and the Public Transport Corporation were also given an opportunity to review the relevant functional and architectural aspects of the bids.

3.3.91 Notwithstanding that the tender evaluation process identified that all bids were non-conforming to varying degrees, generally relating to the non-acceptance of certain risks by bidders associated with access to land owned by the Public Transport Corporation and the interfacing of the extension project with the Jolimont Rail Rationalisation Project, 3 parties were shortlisted in September 1997 with an intention that the non-conforming issues be resolved through subsequent discussions with these shortlisted tenderers.

3.3.92 Following a further assessment of the shortlisted tenders, based predominantly on pricing factors, John Holland Construction and Engineering Pty Ltd, the lowest priced bid of $18.8 million, was selected as the preferred tenderer to undertake the design and construction of the *City end* of the Exhibition Street Extension.

3.3.93 Subsequent discussions with the preferred tenderer resulted in the satisfactory resolution of non-conforming issues and an agreement for certain additional enhancements to the proposal. This resulted in the increase of the proposed contract price from $18.8 million to $19.6 million, which compared favourably with the second lowest tender of $19.9 million. Consequently, **in October 1997 the Minister for Planning and Local Government formally announced the selection of John Holland Construction and Engineering Pty Ltd as the successful tenderer for the project, for a contract price of $19.6 million.**

3.3.94 A Design and Construct Contract was subsequently entered into between VicRoads, on behalf of the State, and the successful tenderer. The contracted works required to be delivered by the successful tenderer include the extension of Exhibition Street from Flinders Street to Batman Avenue and modifications to Batman Avenue from the new Exhibition Street Extension to the edge of Transurban's work near Olympic Park, with the contracted works commencing in October 1997.

"City end" of the Exhibition Street Extension works.

3.3.95 A Project Management Agreement was also entered into in March 1998 between VicRoads and the Melbourne City Link Authority which sets out the respective roles and responsibilities of both parties associated with the delivery of the extension project.

3.3.96 As at March 1999, VicRoads had agreed with the contractor to 4 contract variations which increased the agreed contract sum by a net $600 000. The variations related to changes in the scope of the works in the vicinity of the Melbourne Park and Federation Square access roads, additional costs required to be incurred by the contractor associated with reduced access times to the sites as a result of the acceleration of the Jolimont Rail Rationalisation Program works by the Public Transport Corporation, offset by reduced costs associated with the transfer of responsibility for works associated with tolling facilities to Transurban and a reduction in electrical work requirements. VicRoads advised that these variations will have no impact on the project completion dates and that the increased costs are being accommodated within the project's overall budget, which included a contingency sum.

3.3.97 **The audit analysis of the arrangements associated with the development and operation of the *City end* of the extension concluded that the State has accepted the construction risk, that is the risk of completion and delivery of this section of the extension within agreed completion dates and in accordance with agreed design and performance specifications. However, by virtue of the payment of an expected contract sum of $37.5 million by Transurban to the State upon completion and delivery of the *City end* of the extension, the State aims to recoup the total cost of its design, construction and delivery.** Further comment on these arrangements, including the payment of a contract sum, is provided later in this section of this Report.

"Punt Road end" of development

3.3.98 In June 1997, the Melbourne City Link Authority issued a formal notice to Transurban under the provisions of the Melbourne City Link Concession Deed which advised that the Government intended to proceed with the extension project, and the works which would be required to integrate the City Link with the Exhibition Street Extension. Under the notice, the reasonable costs incurred in relation to the additional works were to be met by the State.

3.3.99 Subsequently, in August 1997 Transurban submitted a proposal to the Melbourne City Link Authority to develop the entire extension project on the basis of a partial BOOT (build, own, operate and transfer) arrangement. In particular, the proposal provided for Transurban to design, construct, finance, operate and maintain the *Punt Road end* of the extension, and to operate and maintain the *City end* of the extension which was to be designed and constructed by the State. Under the proposal, Transurban would be granted a right to toll the entire extension over a period of 34 years, however, the company would be required to pay the State a specified amount upon the completion of the *City end* works. This payment is expected to meet the cost to the State for the design, construction and delivery of the *City end* of the project.

3.3.100 A team of financial consultants was engaged by the Authority in September 1997 to review the Transurban proposal with the objective of comparing it with alternative private sector financing options. These consultants subsequently concluded that the proposal, which was to be debt financed, was superior to alternative arrangements and represented the best financial outcome for the State.

3.3.101 During the period September 1997 and March 1998, while construction of both the *Punt Road end* and the *City end* of the project had commenced and was proceeding, extensive negotiations were being undertaken between the Authority and Transurban regarding the financing of the project. The construction costs incurred during the period of negotiations were being initially met by the Authority from funding provided by the Government from the Better Roads Trust Account which is mainly sourced from motorist fuel levies. However, as it was considered that the Authority could only sustain further drawdowns from this source until May 1998, other financing arrangements needed to be established by the Authority, given that Transurban was unable to reimburse the State for construction outlays on the *Punt Road end* of the extension until the project contractual arrangements were finalised, and would not pay to the State the specified contribution sum for the *City end* of the extension until the completion of the project.

3.3.102 As the negotiations between the parties had extended beyond the envisaged timeframe and as there was a need to secure funding for the project, consistent with previous understandings the Treasurer in April 1998 approved the following arrangements:

- the Melbourne City Link Authority to secure financing of up to $105 million from the Treasury Corporation of Victoria to fund the construction of the project, with a maturity date for such financing of no later than June 2000. This financing was to be drawn-down in the following manner:
    - up to $45 million to be utilised on an "as required" basis, assuming final negotiations with Transurban would be completed by July 1998; and
    - up to an additional $60 million to be made available only with the Treasurer's prior written consent, in the event that the negotiations with Transurban were not concluded by the above date; and
- in the event that an agreement could not be reached with either Transurban or another third party investor by September 1999 (the expected completion date for the Exthibition Street Extension project), a further proposal incorporating longer-term funding arrangements through a mix of long-term borrowings funded by tolling revenues and budget funding would be presented for the Treasurer's consideration.

3.3.103 Following the successful completion of negotiations between the Authority and Transurban, and the approval of the Docklands and City Link Committee of Cabinet, in late April 1998 the Treasurer was advised that the financing of the extension project would proceed on a partial BOOT basis, as initially envisaged. Under the terms of the agreed arrangements, Transurban would deliver the *Punt Road end* of the extension while the State would construct the *City end* in accordance with agreed design and performance specifications. Transurban and/or its wholly-owned subsidiary, City Link Extension Pty Ltd, would toll and operate both sections of the extension and the State would receive a specified contract sum for the design, construction and delivery of the *City end*.

Exhibition Street Extension works, "Punt Road end".

Contractual arrangements for extension project

3.3.104 To facilitate the implementation of the Exhibition Street Extension project, under the provisions of the *Melbourne City Link Act* 1995, the Treasurer provided approval for the Minister for Planning and Local Government to enter into a number of agreements on behalf of the State. These agreements included the Melbourne City Link Third and Fourth Amending Deeds, the Melbourne City Link Deed amending the Third Amending Deed, the Exhibition Street Extension Concession Deed and the Integration and Facilitation Agreement. The agreements acted to establish the contractual basis upon which the extension project would proceed, and acted to vary the relevant provisions of the Melbourne City Link Concession Deed to facilitate the development. An outline of the key aspects of these agreements follows.

Third and Fourth Amending Deeds

3.3.105 The Third Amending Deed provided for the continuation of works by Transurban at the *Punt Road end* of the extension while negotiations were being finalised to facilitate the integration of the extension project with the City Link project. This agreement also served to:

- amend the City Link project area and property schedule and facilitate the acquisition of additional parcels of land required for the connection, operation and maintenance of the extension project;
- identify the additional works required to be undertaken as a result of the extension project;
- establish an "agreed sum arrangement" under which Transurban would undertake the necessary works associated with the construction of the *Punt Road end* of the extension, and the State's liability for these costs would be capped; and
- adjust the milestone dates for sections of the City Link which were affected by the extension project, while not impacting on the overall City Link completion dates.

3.3.106 Under the terms of this Deed, the State is also required to indemnify Transurban for any costs it incurs relating to the clean-up of contaminated land within the extension project area.

3.3.107 The Fourth Amending Deed provided for various conditions precedent to be satisfied before the required amendments to the Melbourne City Link Concession Deed come into operation to facilitate the implementation of the extension project. The conditions precedent mainly included:

- receipt by the parties of the relevant taxation rulings;
- agreement by the State and the company on amendments to be made to the base case financial model which underpins the financing of the City Link project;
- reimbursement by Transurban to the State of any costs incurred in relation to works completed to date on the *Punt Road end*;
- receipt by the State of a satisfactory security for the payment of the agreed contract sum associated with the *City end* of the project;
- execution of new lending documents in a form and substance satisfactory to the State; and
- requirement that the conditions precedent must be satisfied before the end of December 1998.

Deed Amending the Third Amending Deed

3.3.108 The Third and Fourth Amending Deeds required all conditions precedent to be satisfied by 31 December 1998 for all the contractual arrangements to take effect. Until that time, the works conducted on the extension project were progressing under the formal notice issued by the Government to Transurban in June 1997.

3.3.109 Given that the conditions precedent (known as "financial close") were not achieved by December 1998, it was necessary to extend the cut-off date of the Fourth Amending Deed which, under the provisions of that Deed, was done by an exchange of correspondence. Transurban and the State also entered into the Melbourne City Link Deed Amending the Third Amending Deed to extend the date for completion of "financial close" to 31 March 1999. However, all conditions precedent under the Third Amending Deed were satisfied on 31 December 1999.

3.3.110 Upon the achievement of financial close under the above Deeds, the State and Transurban entered into 2 further agreements, namely the Exhibition Street Extension First Amending Deed and the ESEP Contract Sum Payment Directions Agreement. The first of these agreements introduces the ESEP Contract Sum Payment Directions Agreement, and deals with relatively minor amendments to the Exhibition Street Extension Project Concession Deed. The second agreement deals with the contract sum payable to the State on delivery of the *City end*, ensuring that the payment is separate from Transurban's existing debt security arrangements, and dealing with interest payable in the event of the early or late delivery of the *City end*.

3.3.111 Audit was advised that the delay in the finalisation of the financial close was due to various factors, including the greater than anticipated period taken for Transurban to finalise financing arrangements and a dispute between Transurban and its contractors constructing the Western Link in June 1998, and the subsequent negotiation of a global settlement between these parties in December 1998.

Exhibition Street Extension Concession Deed

3.3.112 The Exhibition Street Extension Concession Deed between the Minister for Planning and Local Government and City Link Extension Pty Ltd (Clepco), a wholly-owned subsidiary of Transurban, establishes the *City end* of the extension as a stand alone project, and sets out the responsibilities and relationships between the company and the State for its delivery and operation. The Deed is incorporated as part of the *Melbourne City Link (Exhibition Street Extension) Act* 1998, which provides the legislative framework for the extension project.

3.3.113 Under the Deed, the State is obliged to construct the *City end* of the extension in accordance with the project specifications and is required to make available this section of the extension to Clepco to facilitate its operation. In return, Clepco is required to pay to the State an expected contribution of $37.5 million on the delivery of the *City end* of the extension.

3.3.114 The Deed grants a concession to Clepco for a period of approximately 34 years, to December 2033, to operate, maintain, repair and impose tolls on the *City end*. It also sets out the rights, obligations and remedies of the company and the State associated with the *City end* of the extension road. At the end of this concession period, Clepco is required to surrender this road section to the State.

3.3.115 **The principles for risk allocation adopted for the Deed are, as much as possible, consistent with those adopted for the Melbourne City Link Concession Deed. That is, the party best able to control the risks inherent within this type of project has generally been assigned responsibility for those risks.**

3.3.116 The State may, at its discretion, alter any part of the Existing Traffic Environment around the *City end* of the extension, that is, change the number and configuration of traffic lanes and parking arrangements to Exhibition Street, between the intersections of Flinders Street and the south side of Lonsdale Street, and to Flinders Street between the intersections of Wellington Parade South and the east side of Queen Street. However, **in the event that any changes are made to the Existing Traffic Environment which are considered to have a material adverse effect on the tolling revenues of the project, redress may be sought by the company under a specified remedy regime**, as outlined later in this Report.

3.3.117 As control over the streets which are defined to form part of the Existing Traffic Environment around the *City end* of the extension rests with the Melbourne City Council, the State and the Council in March 1999 entered into an agreement which provides for the parties to consult and obtain written consent before changing the Existing Traffic Environment to avoid or minimise any adverse consequences under the terms of the Deed.

3.3.118 Under the Exhibition Street Extension Concession Deed, a failure by the State to provide the necessary support to enable Clepco to perform its obligations under the Deed will be treated as an *Appendix Event* which may need to be redressed under the material adverse effect regime. Acts of prevention by the State which hinder or prevent the implementation of the project or the levying of tolls, and other events which may be considered to have a material adverse effect, include the following:

- the existence of pollution on project land accessed by the company to carry out its tolling and traffic management obligations, which was caused by the State prior to the company taking possession of the land;
- the alteration of any part of the Existing Traffic Environment;
- a failure by the State to provide the level of support to the extension as that afforded by the State to other "Principal Traffic Routes";
- the alteration of certain transport policies which result in the interference of traffic flows on roads to access the extension road, and changes to transport policies which discriminate against toll roads;
- certain changes to State and Commonwealth laws which have a specific and demonstrable effect on the project;
- certain industrial action directed at the project resulting from an act of omission by the State or an organised campaign in opposition to the project;
- native title claims on project land; and
- *force majeure* events, that is, events which are outside the control of the company which do not relate to risks accepted by the company.

3.3.119 **These events will result in remedies being made available to the company only if the company has been materially and adversely affected by the level or timing of project revenues, or where they impact on the company's ability to service its debt.** The parties to the Deed are required to negotiate in good faith to determine whether such an event has occurred and whether the material adverse effect regime will apply.

3.3.120 The appropriate methods of redress for an *Appendix Event* may include variations to the terms of the concession period (but generally not beyond a period of 43.5 years from the expected completion date of the City Link), altering the risk allocation between the parties, varying the right of the State to receive moneys under the project documents, varying the company's ability to charge tolls, and a financial contribution from the State. The method of redress involving a contribution by the State is only available under certain circumstances, and only as a measure of last resort unless the event relates to the alteration of any part of the Existing Traffic Environment in which case it becomes the measure of first resort during the first 10 years of operation of the extension.

3.3.121 Other key terms of the Exhibition Street Concession Deed include the following:

- **The company will pay the State an expected contract sum of $37.5 million on delivery of the *City end* of the extension works**;
- **In the event that delivery by the State of the *City end* of the extension occurs before December 1999, the company shall pay the State a further amount equal to 86 per cent of the actual gross tolling revenue derived from the extension up to that date. Conversely, in the event that delivery occurs beyond that date, the contract sum of $37.5 million will be reduced on the basis of agreed sums specified within the Deed**;
- The State has acknowledged that the extension is intended to be an integral part of Melbourne's road network and undertakes to manage, maintain, restore and repair "Principal Traffic Routes" which are required to access the *City end* of the extension;
- The Deed does not restrict the right of the State to manage or change Melbourne's transport network. However, if a change to the transport network involves a connection of a road to the *City end*, or changes to this section to enable the proper integration of the road within the network, the State will be liable for the cost of the variation to the scope of works. The State is also required to indemnify the company against certain losses and costs incurred should such a variation result in loss of tolling revenue by the company;
- **In the event that the State makes a "compensable enhancement" to the road transportation network arising from its right to manage or change the network, the company and the State are required to consult in good faith and to agree on the amount of additional toll revenue likely to be derived by reason of the enhancement, with the company to annually pay to the State 50 per cent of the agreed amount**. A compensable enhancement does not include certain events, such as a change in State laws or application of such laws, a change in the management or operation of the transportation network which has been implemented to address a material adverse effect, or the alteration of any part of the Existing Traffic Environment the effect of which is reflected in a positive net present value benefit to the company;

- The company has the right and obligation to erect, display, maintain and repair road and traffic direction signs and advertising boards on project land to facilitate the efficient operation of the *City end* of the extension. The State may require the company to remove such signs at the end of the concession period and make good any damage caused by their replacement or removal. The State is responsible for directional signs relating to the *City end* outside the project land;
- The company is to be provided access to areas designated as project land to enable the company to install the electronic tolling and a traffic management system. These works comprise the design, construction and commissioning of a tolling system and the supply, installation and construction of certain traffic management works. Where the company is only able to access the project land through the land managed by the Public Transport Corporation, the company is required to notify the Corporation of required access dates;
- From the date of delivery of the *City end*, the company bears the risk of loss or damage to the extension and the tolling works. The State will indemnify the company for losses or damages caused by the State breaching its obligations to execute the *City end* works, or from a reckless act or omission by the State or its agencies where they "step-in" and exercise certain rights;
- The company has given certain undertakings to the State, including the nature of the business to be carried out by the company, obtaining prior approval from the State to any material changes to the financial and traffic models underpinning the project, and the maintenance and repair of the *City end* with good practices and standards;
- From the date of delivery of the *City end*, the State will grant the company a lease on the project land to enable the company to carry out its obligations under this Deed, for an annual nominal rental amount of $100;
- During the concession period, the company is required to advise the State of any material damage or disrepair to the *City end*, together with the proposed remedy and timing of the remedy by the company;
- Failure by the State to deliver the *City end* of the extension by early December 1999 will not constitute a breach of this Deed or give rise to a liability for damages to the company. However, if delivery has not occurred by December 2004, the State shall pay the company a specified compensation amount;
- The State has certain *"step-in rights"* where an operating default by the company has occurred. An operating default is defined as a failure by the company to perform certain obligations in respect of the *City end* and the tolling system which either materially adversely affect the maintenance or operation of the extension or increase the risk of imminent death or injury to users. The State is required to give notice to the company regarding the nature of the operating default and, if the company does not address the risk, the State must notify the company of its intention to exercise its "*step-in rights*". In such cases, the State may operate, repair or maintain the *City end* to address these risks or mitigate their consequences. While the State has no right to the tolls levied during the period of default, the company is required to pay to the State the reasonable costs incurred by the State in exercising its "step in rights";

- Where the State or the company become aware of an Environmental Impact Statement before the operative date of the Fourth Amending Deed, either party may terminate the Exhibition Street Extension Concession Deed. However, if the State only becomes aware of this fact after the delivery of the *City end*, the State must provide a limited indemnity to the company against the costs to be incurred to comply with the Statement. In the event that the State terminates the Deed after the operative date of the Fourth Amending Deed but before delivery of the *City end*, the State is required to pay to the company a termination amount in accordance with the arrangements;
- The State may also terminate the Deed if after an operating default by the company, remedy of such a breach has not been achieved by the company by a specified date. An event of default is a breach by the company of its obligations, warranties and representations, the consequences of which are material and which adversely affect the users of the extension;
- The State bears the risk of riots, blockades or other forms of civil commotion where these events are a result of either an act by the State relating directly to the project or an organised campaign opposing the development of the project or other State projects or policies;
- The State is required to indemnify the company against any liability for taxes or duties and local government rates or charges applied with respect to the project land;
- The company is required to effect and maintain a number of insurance polices; and
- The company is required to comply with any clean-up notice issued after delivery of the *City end*, pursuant to the *Environment Protection Act* 1970.

3.3.122 At the end of the concession period, the company will surrender the *City end* of the extension to the State in a condition which complies with the Deed and other project documents. The company must also procure the novation to the State of those service contracts relating to the extension and grant a licence to the State for the necessary intellectual property rights of the tolling system and the plant, to enable the State to operate the *City end* and the tolling system.

Integration and Facilitation Agreement

3.3.123 The Integration and Facilitation Agreement provides the framework for dealing with issues which are common to both the Melbourne City Link Concession Deed and the Exhibition Street Extension Concession Deed. The agreement is incorporated as part of the *Melbourne City Link (Exhibition Street Extension) Act* 1998, which provides the legislative framework for the extension project.

Overall audit assessment of risk allocation

3.3.124 Based on the audit analysis of the terms and conditions incorporated within the extension project documentation, Transurban is responsible for the delivery of the *Punt Road end* of the project in a manner consistent with the project scope and technical requirements. **Consequently, the risks associated with the construction of the *Punt Road end* of the project are borne by Transurban. The construction risk associated with the *City end* of the project has been retained by the State.**

3.3.125 Under the contractual arrangements, Transurban and/or its subsidiary, Clepco will be responsible for the operation and maintenance of the entire extension road over the concession period. The State has not made any representation or provided any warranties to the company with respect to traffic usage of the entire extension or any matter which may affect traffic usage. **Consequently, the company has also accepted the traffic and revenue risk for the term of the concession. Traffic risk is a key risk impacting on the financial viability of the project as toll revenue projections are based on traffic estimates determined by the company. Under the established arrangements, Transurban and/or its subsidiary Clepco will bear the risk of reductions in traffic volumes and associated toll revenue brought about by various factors including incorrect traffic flow projections, adverse economic conditions and changing travel patterns and habits.**

3.3.126 **The State may, at its discretion, alter any part of the existing traffic environment around the *City end* of the extension. However, in the event that any changes made to the existing traffic environment are considered to have a material adverse effect on the tolling revenues of the project, redress may be sought by the company under a specified remedy regime.**

3.3.127 **Finally, as Transurban is required to develop, provide and maintain an electronic toll collection system, the risks associated with the operation of such a system are to be borne by the company.** These mainly include the costs of system development, operation, maintenance and upgrading, technical obsolescence in relation to the plant required to operate the entire extension, and inadequate vehicle recognition.

Status of extension project

3.3.128 As at 31 March 1999, the total cost of the Exhibition Street Extension was estimated by the Melbourne City Link Authority at $92.3 million, with a cost of $63.8 million associated with the *Punt Road end* of the project, and $28.5 million associated with the *City end* of the project, and holding and administrative costs. The actual cost of the entire project incurred at that date was $66.7 million, of which $47.3 million was related to the *Punt Road end* of the project. While as at 31 March 1999 only an amount of $42.7 million of the project cost had been funded by Transurban, upon delivery of the *City end*, it is anticipated that the total project cost will be met by Transurban.

Disputes between the parties

3.3.129 Since the commencement of construction works on the Melbourne City Link in May 1996, Transurban has submitted various claims to the Melbourne City Link Authority for relief against the State, associated with various events which were considered to have either adversely impacted on the progress of the Melbourne City Link project or have a material adverse effect on the ability of Transurban to repay the project debt, and the level or timing of outgoings incurred or paid in respect of the project. In most cases, these claims have been rejected by the Authority as they have been assessed to involve matters associated with the design and construction contracts between the company and its contractors, to which the State is not a party. The most notable instance related to the construction of the Western Link.

3.3.130 In August 1997, Transurban served a Supreme Court writ on the State in relation to disputes that has arisen regarding:

- the assignment of responsibility for the operating costs of licensed roads during the construction of the Link; and
- access by Transurban to "non-project land" for the construction of permanent works to be performed by Transurban.

3.3.131 These matters were subsequently settled between the parties in September 1997, however, either party had the right to reinstate the Supreme Court proceedings at a later time. In particular, it was resolved between the parties that, as an interim measure, the State and Transurban would pay an equal portion of the maintenance costs for the Tullamarine and South Eastern Freeways during the construction period. In respect to land issues, the State will acquire the "non-project" land and share the cost of acquisition equally with Transurban. However, Transurban has re-commenced these proceedings, with negotiations currently in progress aimed at settling this claim.

3.3.132 In the period April 1998 to March 1999, Transurban served the State with 9 further claims which were considered by Transurban to have a material adverse effect on the project. Two of these claims were subsequently withdrawn by Transurban and the remaining claims have been rejected by the Authority as not representing valid claims under the terms of the contractual arrangements.

3.3.133 At the date of preparation of this Report, audit was advised that there were no disputes which related specifically to the Exhibition Street Extension project.

Tolling of the Exhibition Street Extension and the Melbourne City Link

3.3.134 As stated earlier, similarly to the Melbourne City Link, the construction and operation of the Exhibition Street Extension is to be ultimately financed from tolls collected from private motorists for the use of the extension road over the concession period. Under the established arrangements, Transurban is empowered to fix, charge and collect these tolls consistent with parameters established within the contractual documentation.

3.3.135 From the date of delivery of the City Link and the delivery of the Exhibition Street Extension, the company is obliged to operate the tolling system in accordance with specified standards and requirements and in a manner that does not impede the flow of traffic. To ensure the proper integration of the Melbourne City Link and the Exhibition Street Extension, the tolling system must be able to operate across both roadways.

3.3.136 The system must be operated so that vehicles can travel at design speeds without being required to either stop or slow down. To enable this to occur, electronic devices known as "transponders" will be placed in or on vehicles to enable the automatic collection of tolls once a tagged vehicle passes beneath tollway detection gantries. Roadside equipment will then electronically transfer the transponder identification to the control site and the user's account, which will be debited with the appropriate toll. Occasional users of the roadways will be able to obtain passes allowing unlimited use of the City Link for a given day.

City Link tollway detection gantry.

3.3.137 In March 1998, Transurban announced details of the tolls which will first apply for the quarter ending 31 March 2000. Table 3.3H below details the maximum permissible charge tolls to be applied to vehicles for each tollable section of the roadway. The use of the toll road by exempt vehicles such as police vehicles and ambulances, will not attract tolls.

TABLE 3.3H
MAXIMUM PERMISSIBLE TOLLS PAYABLE BY MOTORISTS, QUARTER ENDING 31 MARCH 2000
($per vehicle)

Tollable section	*Car*	*Light commercial vehicle*	*Heavy commercial vehicle*	*Motor-cycle*
Tullamarine Freeway (between Moreland Road and Brunswick Road)	1.01	1.61	1.91	0.50
Western Link - Section 1 (between Racecourse Road and Dynon Road)	1.01	1.61	1.91	0.50
Western Link - Section 2 (between Footscray Road and Westgate Freeway)	1.26	2.01	2.39	0.63
Westbound Tunnel (between Punt Road and Burnley Street)	1.26	2.01	2.39	0.63
South Eastern Arterial (between Punt Road and Burnley Street)	1.01	1.61	1.91	0.50
Eastbound Tunnel (between Sturt Street and Burnley Street)	2.26	3.62	4.50	1.13
South Eastern Arterial (between Burnley Street and Toorak Road)	1.01	1.61	1.91	0.50
Exhibition Street Extension - *City end* (between Exhibition Street and the Swan Street intersection)	0.63	1.00	1.19	0.31
Exhibition Street Extension - *Punt Road end* (between Punt Road and Swan Street intersection)	0.63	1.00	1.19	0.31

3.3.138 Audit was advised by the Melbourne City Link Authority that, as suitable motorcycle transponders are yet to be developed, Transurban has indicated that motorcycles will be able to use the tollway free of charge in the interim.

❒ ***RESPONSE*** *provided by Chief Executive Officer, Melbourne City Link Authority*

The Authority wishes to respond to the observation by the Auditor-General's Office that "The Government decision to establish the City Link as a toll road was not supported by a financial model which compared project costings on the basis of private sector financing versus government borrowings".

Prior to the Government decision to proceed with the City Link, the Department of Treasury and the Southern and Western Bypasses Co-ordination Team did undertake a base-case cost analysis of public sector delivery. This work showed that the relative costs of private and public sector delivery depended on a number of key assumptions and that, depending on the value of these assumptions, private sector delivery could be competitive and indeed cheaper than public sector delivery. The work was not progressed beyond this point because Government financing of the project was not a feasible option. Responsible management of the State finances and the debt position precluded this.

EXTERNAL FINANCIAL REPORTING BY THE LOCAL GOVERNMENT SECTOR

Timeliness of year-end reporting

3.3.139 The *Local Government Act* 1989 requires local government entities to prepare annual reports, which include audited financial statements and audited compulsory competitive tendering (CCT) statements and to forward these annual reports to the Minister for Planning and Local Government by the end of September each year.

Public accountability within municipal councils is essential for good governance. (Photo courtesy of Wyndham City Council.)

3.3.140 For councils to satisfy this legislative reporting requirement for the 1997-98 financial year, a deadline of 4 September 1998 was established by my Office for local government entities to provide their completed statements, and for the audit service providers engaged to assist me in these audits to submit their reports for review by my Office to enable issue of my audit opinions so that councils could achieve their legislative deadlines.

3.3.141 The previous 2 *Reports on Ministerial Portfolios* to the Parliament have provided an assessment of the timeliness of external financial reporting by the local government entities. In this Report, I have outlined the results of the 1997-98 external financial reporting cycle.

3.3.142 **It is pleasing to report that since 1995 there has been a threefold improvement in the timeliness of financial reporting by local government entities, despite the need for these entities to address a number of substantial industry, financial and accounting issues during this time, including:**

- industry restructuring as a consequence of council amalgamations;
- introduction of a compulsory competitive tendering reporting and audit regime covering expenditure in excess of $1.5 billion;
- revised reporting for unfunded superannuation liabilities valued in excess of $350 million;
- application of new and revised accounting standards; and
- new disclosures of related-party details for councillors and senior management.

3.3.143 Table 3.3I illustrates the extent to which local government entities had complied with the reporting deadline established by my Office.

TABLE 3.3I
TIMELINESS OF EXTERNAL FINANCIAL REPORTING
BY LOCAL GOVERNMENT ENTITIES
(number of entities)

Description	*1995-96*	*1996-97*	*1997-98*
Local government entities meeting audit deadlines	36	76	82
Local government entities not meeting audit deadlines	63	23	17
Local government entities not providing financial statements to audit by 30 September	25	7	2
Extensions of time by Minister for submission of annual reports	63	46	19

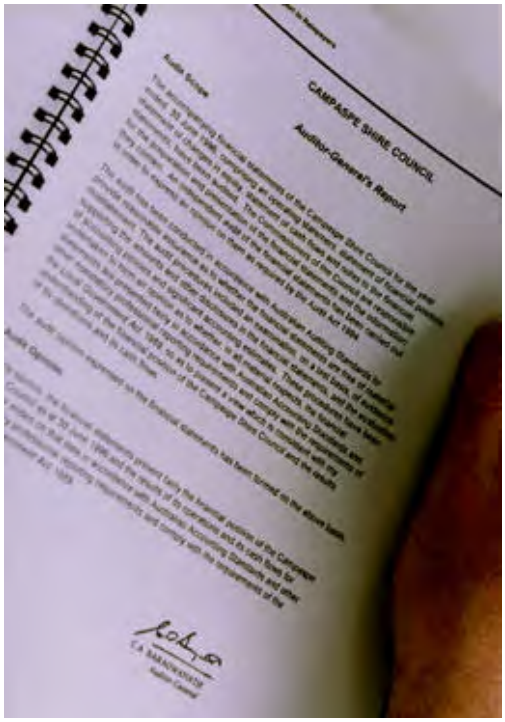
3.3.144 The table shows that for the 1997-98 financial year 17 of the 99 local government entities did not comply with the audit deadline which compares favourably with the 2 previous financial years.

3.3.145 In addition, only 2 entities had not provided the requisite information to my Office by 30 September 1998, compared with 7 and 25 entities for the 1996-97 and 1995-96 financial years, respectively. Furthermore, the *Local Government Act* 1989 provides that the timeframe for annual reports to be forwarded to the responsible Minister may be varied only at the Minister's discretion. The table also indicates that requests for extensions of time have decreased substantially since the 1995-96 financial year.

3.3.146 **With the introduction in the 1998-99 financial year of a new performance reporting regime which will be subject to audit, the challenge remains for all local government entities to continue to provide timely information to ratepayers within the established legislative reporting time frames.**

Compliance with Australian Accounting Standards

3.3.147 Local government entities are required by legislation to prepare their financial statements in accordance with Australian Accounting Standards, particularly Australian Accounting Standard AAS 27 - *Financial Reporting by Local Governments*, and other reporting requirements as prescribed in the *Local Government Act* 1989 and the Local Government Regulations 1990.



The Auditor-General plays an important role in the accountability of local government entities.

3.3.148 **During the 1997-98 financial year, the vast majority of local government entities complied with Australian Accounting Standards and legislative disclosure requirements**. Specifically, 95 local government entities received confirming audit opinions on their financial statements for the year ended 30 June 1998 (89 entities for the year ended 30 June 1997), while 4 entities received qualified audit opinions on their financial statements (8 entities for the year ended 30 June 1997). In relation to the Auditor-General's report on council CCT statements, all councils received confirming audit opinions.

3.3.149 Table 3.3J outlines the key reasons for the issue of the non-confirming Auditor-General opinions on the financial statements of local government entities.

TABLE 3.3J
BASIS OF NON-CONFIRMING AUDITOR-GENERAL OPINIONS
(number of entities)

Issue	*1997-98*	*1996-97*
Inadequate or unreliable fixed asset records	2	4
Inappropriate recognition or disclosure of unfunded superannuation liabilities	-	2
Doubt over the value of receivables	-	1
Uncertainty regarding the future viability of the entity	*(a)* 2	1
Total	**4**	**8**

(a) Uncertainty relating to the going concern status of a council and a regional library corporation.

3.3.150 **It is important that the relevant local government entities take appropriate remedial action in the 1998-99 financial year to ensure the resolution of issues related to audit qualifications so that confirming opinions can be provided at the conclusion of the financial year.**

Issues arising from the 1997-98 audit cycle

Deficiencies in annual reporting

3.3.151 To ensure the integrity of the annual reporting process for local government entities, upon completion of the 1997-98 audit cycle, my Office examined the annual reports of all municipal councils to determine whether the published financial statements, CCT statement and associated audit opinions for the council were the same as those cleared by my Office. This review identified that:

- 3 councils had published only abridged details of their financial statements in their annual reports;
- 1 council had backdated by one month the certification date of the financial statements and CCT statement compared with the certification date for those statements as cleared by my Office;
- 1 council's "responsible person remuneration payment" details were excluded from its published financial statements;
- 2 councils had not publish their CCT statement; and
- 4 councils had not included the audit opinions in their annual reports.

3.3.152 As part of the audit review, the relevant councils were notified of the discrepancies identified in their annual reports.

3.3.153 **These matters are of concern given that they act to weaken the accountability process within local government. Accordingly, it is critical that the processes adopted by the sector for the preparation of annual reports ensure that such reports contain the audited financial and CCT statement including the audit opinions actually issued by my Office.**

Deficiencies in accounting for infrastructure assets

3.3.154 Infrastructure assets constitute significant resources managed by councils. The accurate recording of these assets is, therefore, essential to enable proper accountability and the effective management of these resources.

3.3.155 The transitional arrangements under the Australian Accounting Standard AAS 27 - *Financial Reporting by Local Governments* provided for the valuation and recognition of infrastructure assets by no latter than 30 June 1997. Notwithstanding the cessation of the transitional arrangements in the 1996-97 financial year, the financial audit process for the 1997-98 financial year revealed that **more than one-third of councils were required to make substantial corrections to the recorded value of infrastructure asset holdings**. In addition, a qualified audit opinion was required to be issued on one council's financial statements due to the failure to identify and value all its drainage assets.

3.3.156 The deficiencies in the recognition, valuation and depreciation practices for infrastructure assets may adversely impact on the effectiveness of their management and may expose ratepayers to renewal and replacement costs which could have been avoided. **Councils should consider whether best practice guidelines should be developed for infrastructure assets to enhance the accounting and reporting for these substantial assets.**

Other emerging issues

Performance reporting and audit regime

3.3.157 To facilitate good corporate governance and enhance public accountability within municipalities, in October 1996 the *Local Government Act* 1989 was amended to provide for a council performance reporting and audit regime commencing in the 1998-99 financial year. The key features of these new arrangements are:

- Councils required to submit to the Minister at the end of each financial year a 3 year corporate plan, which must include an annual business plan containing performance targets and measures by which council's performance can be judged;
- After the end of each financial year, councils must prepare a performance statement that identifies the performance targets and measures previously provided in the annual business plan and the extent to which those targets were met;
- The performance statement must be included in council annual reports and be submitted to the Minister within 3 months of the end of the financial year. If a council fails to achieve the targets set out in its business plan, an explanation for the non-achievement of targets must be contained in the performance statement; and
- Council performance statements must be subject to management and audit certification.

3.3.158 **The Local Government Branch within the Department of Infrastructure advised that, for the 1998-99 financial year, it is intended that councils will report performance against the target indicators as published in their 1998-99 corporate plans.**

Audit committee and internal audit developments

3.3.159 In my May 1998 *Report on Ministerial Portfolios*, I provided the Parliament with an assessment of the operation of audit committees and internal audit within the local government sector. In particular, it was concluded that the use of audit committees and internal audit had not been universally adopted across the local government sector and, as a consequence, corporate governance within the sector was diminished.

3.3.160 **Following consultation between the Local Government Branch within the Department of Infrastructure, peak industry bodies within the sector and individual councils, the Local Government Branch in March 1999 issued draft *Best Practice Guidelines for Council Audit Committees,* which were developed on its behalf by the Australian Accounting Research Foundation.**

3.3.161 Key features of the guidelines provide that:

- councils should establish and maintain effective audit committees;
- audit committees to be advisory committees of council independent of management and should report to council at least quarterly;
- members of audit committees to posses appropriate skills, with a majority of members, including the chairperson, to be appointed as independent members; and
- the Chief Executive Officer should not be a member of the audit committee but shall attend each committee meeting along with the council's internal auditor.

3.3.162 Under the guidelines, the recommended role for internal audit is to assist councils in the effective discharge of their responsibilities by reviewing key risk areas and examining issues of efficiency, economy and effectiveness. The guidelines also outline model charters for audit committees and internal audit functions.

Business unit reporting developments

3.3.163 In my May 1998 *Report on Ministerial Portfolios*, I provided the Parliament with an assessment of council management of municipal business undertakings. Among other matters, the review disclosed that 12 councils with contract expenditure of $68 million in the 1996-97 financial year were unable to identify surpluses or losses from business unit operations. I therefore recommended that the Local Government Branch develop best practice guidelines for financial and performance reporting by business units.

3.3.164 **Following consultation with peak industry bodies within the sector and councils, the Local Government Branch is currently developing *Best Practice Guidelines for Business Unit Reporting and Major Contracts*.**

3.3.165 The reporting principles underlying the proposed guidelines are:

- councils should ensure that there is an adequate system of monthly internal reporting on the financial performance of business units and major contracts;
- internal reports on business units and major contacts should be reviewed by council's audit committees and internal audit in accordance with the best practice audit committee guidelines;
- the aggregate financial performance of business units should be reported in councils' annual report; and
- major variations from the planned financial performance of major contracts should be reported to the Minister.

3.3.166 **These guidelines are expected to be finalised and issued by the end of the 1998-99 financial year**.

❒ ***RESPONSE*** *provided by Secretary, Department of Infrastructure*

Steps will be taken during the remainder of 1999 to continue with the development of best practice guidelines to account for the infrastructure assets of municipalities.

The continuous improvement achieved by municipalities in their reporting for 1997-98 indicates a greater commitment to the observance of accounting and auditing standards.

MARIBYRNONG CITY COUNCIL - QUAY WEST BUILDING LEASE TERMINATION

3.3.167 The former City of Footscray in the 1980s progressively acquired a 7.5 hectare site bounded by Napier, Moreland, and Hopkins Streets, Footscray, adjacent to the Maribyrnong River, for the purpose of its resale and commercial redevelopment by a private developer. The passage of the *Footscray Land Act* 1988 assisted in the assembly of the land for the site.

3.3.168 By the end of 1989, the City had considered 2 development proposals for the site, however, these did not proceed because, in the first instance, the site was considered unsuitable for the type of development proposed and, in the second instance, the City's nominated developer was unable to raise the necessary project finance.

3.3.169 The City subsequently examined alternatives arrangements to enable the development of the site, then known as the "Quay West Project", to proceed. At that time, it was proposed that the development would include offices, residential and retail areas, water-edge restaurants, a hotel and craft market, and public mooring facilities.

3.3.170 In 1991, as a first stage of the proposed "Quay West Project", the City entered into an arrangement with a private investor for the construction of an office building on a 0.41 hectare parcel of land located on the western end of the site comprising 6 110 square metres of leaseable area and 155 car parking spaces. **The construction of the building commenced in September 1991 and was completed by August 1992 at a cost of around $17 million.**

Office building constructed as part of the Quay West Project.

Lease arrangements

3.3.171 The financial arrangements associated with the lease of the office building involved a number of contacts between various parties including the City, an investor, a builder, a financier, and the Department of Treasury and Finance. In particular, the arrangements included:

- an agreement which provided that, upon completion, the building would be leased by the City for a period of 20 years; and
- an agreement between the City and the Minister for Finance under which the majority of the building would be sub-leased to the Department of Treasury and Finance over a 10 year period for use by a number of State Government agencies.

3.3.172 The key rights and obligations assumed by the City under the lease arrangements were:

- *Head lease with investor* - requiring the City to make rental payments compounding annually at 6.5 per cent over the 20 year period, with these rental payments essentially structured to repay the debt incurred by the investor to finance the building's construction;
- *Sub-lease with Department of Treasury and Finance* - providing a 10 year lease to the Department with two 5 year renewal options, and with rental income to be based on market rates and to be reviewed bi-annually;
- *Refurbishment, repair and maintenance obligations* - requiring the City to meet any costs associated with the repair of any structural defect found in the building, costs of refurbishment of the building which was to occur 4 times during the building tenancy, and certain building plant and machinery repair costs. Such costs could not be passed-on to either the investor or the sub-tenant; and
- *Sale proceeds* - providing the City with an entitlement to 25 per cent of net sale value of the building less any outstanding borrowings payable by the investor, at the expiry of the lease.

3.3.173 These arrangements contained an inherent risk that the rental income to be received by the City from the sub-lease of the building would not sustain its rental obligations to the investor, given that rental income was exposed to fluctuations in market conditions while rental payments were fixed to increase progressively. In addition, any losses arising from the rental arrangements would be compounded by repair and maintenance costs which were not recoverable from either the investor or the Department. In essence, **the City assumed most of the financial risks associated with the building.**

3.3.174 As a result of the Government's amalgamation of metropolitan municipal councils, the City of Maribyrnong was created in December 1994 replacing the City of Footscray (and parts of the former City of Sunshine) and legally assumed the rights and obligations under the lease arrangements.

Lease termination

3.3.175 Given the highly unfavourable nature of the leasing arrangements for the building, in early 1996 the City offered to purchase the property outright from the investor by using proceeds from the sale of the City's municipal electricity undertakings under the State's electricity privatisation program. However, this offer was declined by the investor. Nevertheless, following further negotiations between the parties **in March 1998**, **the investor offered to extinguish all the City's obligations and responsibilities under the lease arrangements in consideration of a single payment from the City of $24 million.**

3.3.176 In view of the investor's offer, the City requested its property adviser to assess its future lease obligations and was subsequently advised that, **under the least optimistic prediction under the leasing arrangements, the City would incur net losses of $44 million by the end of the lease term in the year 2012, which was equivalent to $30 million in net present value terms assuming a one year vacancy at the expiry of the lease and an ongoing vacancy rate of 20 per cent.** These estimates were later confirmed by an independent consultant engaged by the City to examine the methodology and calculations used by the property adviser.

3.3.177 In April 1998, the City resolved to accept the investor's offer and to raise the necessary borrowings to finance the lease termination payment. Following approval from the Treasurer, the City borrowed $24 million, with principal and interest payments of $39 million in nominal dollar terms to be made over a period ending in 2012.

3.3.178 **Accordingly, the City will incur total cash outflows of $39 million, comprising the termination payment of $24 million and future interest charges of $15 million, to terminate an onerous leasing arrangements which had expected future obligations of $44 million. In addition to the termination payment, since the commencement of the lease the City has incurred aggregate rental income deficits associated with its sub-lease of the property of around $5 million.**

3.3.179 **In essence, the City is committed to a substantial outlay of funds to the year 2012 which will provide no real benefit to ratepayers because of unsound business decisions made in the past in the area of the City's non-core activities.**

Redevelopment of remaining site

3.3.180 Since 1985, there have been 3 different strategies proposed for the entire 7.5 hectare development site which have not proceeded, namely:

- *Riverine Project (1985)* - which envisaged a public and private housing development together with a major hotel for the site. The project was abandoned as the market for medium housing at that time was not conducive to such a development and analysis indicated that a major hotel on the site was not economically viable;
- *City Link Project (1988)* - which envisaged a comprehensive $120 million waterfront complex development, comprising mooring facilities, retail, hotel, cinema and land office development. The project was abandoned due to the developer's inability to secure sufficient finance for the project; and

- *Quay West Project (1991)* - which envisaged a development strategy similar to the above City Link Project, with the initial development comprising the construction of the building referred to above. However, this project was subsequently abandoned because of the uneconomic nature of the building lease.

3.3.181 In 1997, the City formulated a fourth development strategy for the site known as the *Saltwater Crossing Project* which envisaged a $40 million residential, arts and convention centre complex for the site, covering most of its freehold land which represents around 50 per cent of the site.

3.3.182 Following the calling of public tenders, in early 1998 a consortium was appointed to undertake the development. The associated development contracts were conditional on the granting of the relevant planning and heritage permits, Table 3.3K outlines the status of the *Saltwater Crossing Project* at the time of preparation of this Report:

TABLE 3.3K
STATUS OF SALTWATER CROSSING PROJECT

Site	*Development proposal*	*Permit status*	*Expected completion date*
1	40 unit mixed residential	All permits issued	By the end of 1999
2	28 apartments plus College of Art and Design	Council and developer to appeal Heritage Permit conditions	18 months after satisfactory resolution of permit appeals
3	100 unit apartment complex and convention centre	Council and developer to appeal Heritage Permit conditions	30 months after satisfactory resolution of permit appeals

3.3.183 The price for the sale of the land by the City to the consortium was based on latest valuations of $3.3 million for the sites, reduced by $500 000 for costs associated with site remediation and for costs associated with waste removal costs of up to $600 000.

3.3.184 **In effect, the net sale proceeds to be obtained by the City will total $2.2 million, which were consistent with the value of the site at time of valuation. However, in 1993 the site was revalued downward by $11 million from the cost actually incurred on acquisition.**

❒ ***RESPONSE*** *provided by Acting Chief Executive Officer, Maribyrnong City Council*

The Report provides a succinct overview of the history of the Quay West development and the subsequent decisions of the City of Maribyrnong to terminate the lease of the office building and to progress the Saltwater Crossing Project.

We will be referring the Report to Council's Audit Committee for further consideration.

COLAC SHIRE COUNCIL - ACQUISITION OF ABATTOIR

3.3.185 One of the key goals of the Colac-Otway Shire Council as outlined in its municipal strategic statement for the 2 year period of 1996-97 to 1998-99 is to facilitate economic development within the region and diversify the employment base of the municipality. Consistent with this goal, the Council in January 1998 acquired land, buildings and plant assets of a local abattoir which at this time was in voluntary liquidation and proceeded to operate the business as a council enterprise.

3.3.186 The abattoir was acquired by the Council with the aim of attracting a developer to build and operate a new abattoir which would meet export licensing standards and, therefore, be used as an export facility. It was the Council's objective to close its own abattoir once the export facility was commissioned. Irrespective of whether an agreement to build the export facility was secured or not, it was the Council's intention to close its abattoir by December 1998 and to dispose of the residual assets.

3.3.187 Inquires by my Office in December 1998 indicated that, while the Council was negotiating with a developer to build an export facility within the municipality, no firm agreement had been reached and, in addition, the Council's abattoir continued to operate. Accordingly, it was determined to undertake a review of the status of the proposed development and the financial performance of the council abattoir.

Overall cost to ratepayers to acquire and operate a local abattoir was around $1 million.

Proposed development of export facility

3.3.188 Following an assessment of a number of informal expression of interests concerning the development of an export facility, the Council identified **a preferred developer and agreed in April 1998 to enter into a Development Agreement with the preferred developer which would commit the developer to finance and build an export facility by March 1999, and to operate the facility for at least a 5 year period.**

3.3.189 The export facility, which was estimated to cost $13 million and to be financed mainly from borrowings raised by the developer, was to process up to 30 000 livestock units per week for both national and international markets, and employ up to 285 personnel.

3.3.190 The Council's key financial obligations under the proposed Development Agreement were to provide the developer with:

- vacant land on the existing abattoir site at no cost, which was valued at $300 000;
- up to $500 000 of site infrastructure grants;
- future rate concessions for the export facility linked to employment levels at the facility; and
- assistance with seeking further financial support of up to $500 000 from the Department of State Development.

3.3.191 However, by December 1998, the Council and the developer had not executed the proposed Development Agreement. **The key reason for the Development Agreement not being executed was the developer's inability to secure the necessary finance to construct the export facility.**

3.3.192 Audit was advised that the developer has joined with a number of local investors and prepared a revised export facility proposal whereby the developer will build a smaller export facility and then lease the facility to the local investors who will operate the export facility. The financing arrangements associated with the revised proposal was still to be finalised.

3.3.193 **At the date of preparation of this Report, negotiations were continuing with the aim of securing finance for the facility, and the Council has set a deadline of 30 June 1999 for the developer to finalise negotiations on the export facility.**

3.3.194 It is my intention to review and report upon the arrangements entered into by the Council associated with the export facility once a Development Agreement is concluded.

Financial performance of council abattoir

3.3.195 As mentioned previously, the Council in January 1998 acquired the land, buildings and plant associated with the local abattoir which was in voluntary liquidation and proceeded to operate the business as a council enterprise. The costs incurred by the Council associated with the acquisition of the abattoir was $773 000 and, at that time, the annual turnover of the business was estimated at $16 million.

3.3.196 Upon acquisition, the following measures were taken by Council to improve the financial performance of the abattoir:

- an industrial agreement was negotiated whereby abattoir staff waived their rights against the Council to accumulated employee entitlements as at the date of purchase, and agreed to forgo severance payments entitlements for a period of 12 months if staff retrenchments were required;
- only 80 per cent of the former staff were engaged by the Council;
- a Board of Management was established which included expert industry representation to oversee the ongoing management of the abattoir; and
- a monthly budget, financial and performance reporting regime was implemented to monitor its performance.

3.3.197 **Based on the latest available management reports the financial performance of the abattoir was improving and generating positive trading outcomes. However, the overall cost to ratepayers of the Council decision to acquire and operate the abattoir is estimated to be around $1 million.**

3.3.198 The Council has given a commitment to the Victorian Meat Authority that it will not seek licensing of its abattoir beyond 30 June 1999. Notwithstanding this commitment, audit understands that the Board of Management presently has no plan for the orderly closure of the abattoir.

3.3.199 **In order to minimise costs associated with the closure of the abattoir, Council should ensure that the downsizing of the business, staff retrenchments and disposal of residual assets are undertaken in a planned and orderly manner**.

Employee liabilities

3.3.200 As mentioned previously, as part of the acquisition arrangements for the abattoir, the Council negotiated an industrial agreement relating to employee entitlements accrued at the date of sale, and obligations for future severance payments. The industrial agreement which was to operate until January 1999 provided:

- a waiver by employees of all rights for annual leave, long service leave and for wage entitlements accrued at the time of purchase; and
- for severance pay not to be made to employees within 12 months from the time of purchase.

3.3.201 As a result of this agreement, the Council estimated that, at the time of the acquisition of the abattoir, it avoided the assumption of employee entitlement liabilities in excess of $900 000 for long service leave and accrued annual.

3.3.202 **However, legal advice provided to the Council regarding its liability for employee entitlements beyond January 1999 indicted that severance payments when required to be made in accordance with the agreement must cover the employees entire length of service for the Council and the previous owner.**

❒ ***RESPONSE*** *provided by Colac Otway Shire Council*

Council foreshadows the entering into a development agreement with the preferred developer by the end of June 1999. Considerable delay has been experienced as referred to in the Report by the necessity for the developer to obtain finance to construct the export facility. Should the export facility development not proceed, Council will downsize the current business operation and staff retrenchments will occur in order that the existing asset on the abattoir site are demolished and removed.

In response to the comment with respect to legal advice provided to council, Council is again confirming its advice and understanding that in the case of closure minimal redundancies will occur in the case of a small number of staff pertaining to the current boning room operation.

FRAUDS, THEFTS, LOSSES AND IRREGULARITIES IN THE LOCAL GOVERNMENT SECTOR

3.3.203 Accountable officers of public sector agencies other than local government entities are required under relevant legislation to notify the Auditor-General of all cases of suspected or actual theft, arson, irregularity and fraud. However, such arrangements do not exist for councils under the *Local Government Act* 1989.

3.3.204 The losses incurred by entities through theft, fraud, arson and irregularities have the potential to adversely impact on the operations of individual entities. Reporting of such details also assists my Office in determining the most appropriate audit coverage of agencies.

3.3.205 **Legislative amendments should be considered for local government entities requiring annual reporting to the responsible Minister and the Auditor-General of all instances of theft, arson, irregularity and frauds similar to those required of other public sector agencies.**

3.3.206 My audit of local government entities during the 1997-98 financial year indicated an instance of potential fraud in one municipal council. While this matter was raised with the particular council concerned, my Office also initiated a sector wide survey to assist in identifying any major instances of fraud, theft, loss and financial irregularity covering the 1997-98 financial year and the 6 month period ending 31 December 1998. Comment follows on the major instances identified as a result of this process.

Mornington Peninsula Shire Council

3.3.207 Following the receipt by my Office in July 1998 of anonymous allegations of possible fraud at the Mornington Peninsula Shire Council, a preliminary review undertaken on behalf of my Office indicated that, *prima facie,* a case of fraud may exist. The matter was referred by my Office to both the Council and the Local Government Branch within the Department of Infrastructure. Pursuant to the *Local Government Act* 1989, the Minister for Planning and Local Government subsequently appointed a major consulting firm as an Inspector of Municipal Administration to examine and report on the allegations.

3.3.208 As a result of the Inspector's inquires, the services of a senior council employee and another council employee were terminated. The Inspector's report was subsequently forwarded to police which resulted in a number of charges being made against one former employee at this stage.

3.3.209 **The Council has since initiated a review of the senior management organisational arrangements, roles and responsibilities, and internal control procedures.**

Manningham City Council

3.3.210 The Manningham City Council owns and operates the Doncaster Quarry on a commercial basis as a provider of quarry products mainly to the private sector, but also for council purposes associated with road maintenance and other projects.

3.3.211 Following suspicions in early 1999 of fraud at the quarry, the Council carried out a number of investigations into product sale and dispatch processes which indicated potential theft.

3.3.212 The information obtained from the investigations was provided to the police who subsequently charged one council employee and 2 accomplices with a total of 24 cases of theft of cash and quarry stock over 2 years with an estimated value of $38 000. All offenders have acknowledged the thefts and court action is expected to commence in mid-1999. The Council employee's services have been terminated and the Council expects to recover the losses under insurance arrangements.

Melbourne City Council

3.3.213 Since 1995, the Melbourne City Council has outsourced its parking meter collection and car parking management services, which generate annual income of $13 million.

3.3.214 In mid-1998, the City became aware of anomalies in parking meter collections banked by the service provider. Following police investigations, criminal charges were laid in late 1998 against a co-director of the service provider and 3 employees for alleged misappropriation of parking meter revenue estimated to be in excess of $2 million.

Criminal charges are proceeding against members of the company which used to manage the Melbourne City Council's parking meter collection activities.

3.3.215 The City has cancelled all contracts with the service provider and alternative service provision arrangements have been made, including the appointment of separate service providers for the meter revenue collection and meter revenue banking functions.

3.3.216 The former service provider's company is now in liquidation and the City is pursing claims with the company's administrator for recovery of misappropriated funds.

3.3.217 At the time of preparation of this Report, 2 defendants had been tried and convicted by the Courts and committal proceedings against the co-director are pending.

3.3.218 **The City has engaged a consultant to review internal contract management processes associated with the car parking**.

Central Goldfields Shire Council

3.3.219 The Central Goldfields Shire Council was created in January 1995 out of the amalgamation of 4 former municipalities and the Government appointed 3 Commissioners to oversee the amalgamation process.

3.3.220 Following receipt of a public complaint by the Local Government Branch of the Department of Infrastructure, the Minister for Planning and Local Government in October 1997, appointed 2 Municipal Inspectors to review and report on a number of contractual arrangements entered into by the Council during the commissioners' tenure.

3.3.221 The Municipal Inspectors' report which was provided to the Minister in February 1998 advised that:

- one of the Commissioners appeared to use their position as an officer of the Council to arrange future employment with a council service provider on generous terms and conditions commencing immediately upon the termination of that officer's appointment as a Commissioner;
- there were numerous instances where Commissioners failed to follow proper contract procedures and processes, including the direct assumption by Commissioners on a number of occasions of council contracting activities normally undertaken by council's management; and
- there were a number of further deficiencies identified in management control processes.

3.3.222 The Minister subsequently forwarded the Inspectors' report to the police who subsequently charged one of the former commissioner with 10 offences, including 5 counts of criminal misfeasance, i.e. the wrongful and injurious exercise of lawful authority. At the time of preparation this Report, court proceedings associated with the charges were in progress.

❒ ***RESPONSE*** *provided by Secretary, Department of Infrastructure*

Your comments and suggestions have been noted and will be shared with local governments.

THE DOCKLANDS REDEVELOPMENT - DOCKLANDS STADIUM

3.3.223 The Melbourne Docklands comprises an area covering some 220 hectares of land and water which is located near the Spencer Street railway station beyond the west end of the Melbourne central business district. Given its proximity to the Melbourne central business district and the Yarra River, the area has been identified as suitable for redevelopment by successive Victorian Governments.

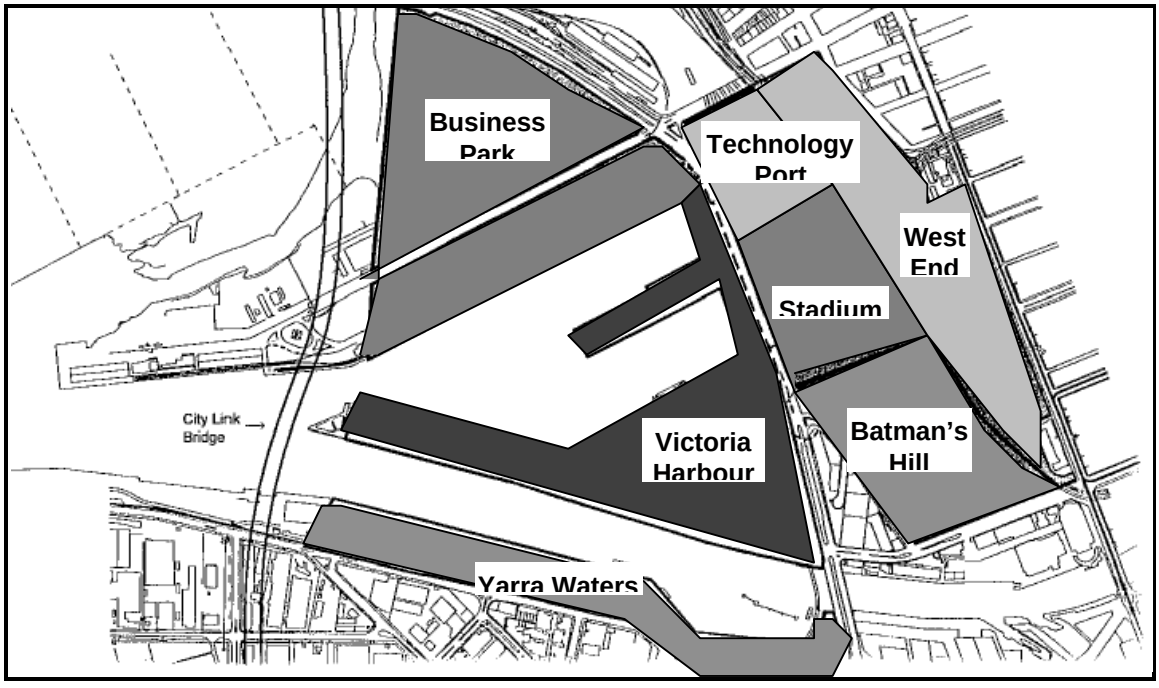
3.3.224 In 1991, the Docklands Authority was formed to:

- investigate development options for the Melbourne Docklands;
- prepare and implement development strategies; and
- promote and encourage the involvement of the private sector in the redevelopment of the area without long-term government funding and with minimum practicable risk to the State.

3.3.225 The Authority undertook planning and research over a period of approximately 3 years, culminating in the Government's acceptance of the Authority's strategy in August 1995, which identified 7 precincts within the Melbourne Docklands for redevelopment, namely, Business Park, Victoria Harbour, Yarra Waters, Batman's Hill, Technology Park (now known as Commonwealth Technology Port), Stadium and West End. The Stadium precinct comprises 2 parts; the Stadium itself and the Remainder of the Stadium precinct.

3.3.226 Chart 3.3L illustrates the locality and size of the 7 development precincts.

CHART 3.3L
THE DOCKLANDS DEVELOPMENT PRECINCTS



3.3.227 The proposed redevelopment of the Docklands area is a massive project to be undertaken over many years, covering an area larger than the central business district itself. The redevelopment was marketed by the Authority across Australia and overseas during 1996. Key features of the marketing strategy, which was designed to encourage developers to bid for the right to acquire and redevelop one or more of the precincts, included:

- a flexible design framework and planning scheme arrangement, which at a later stage included the Docklands Stadium as a major feature;
- the potential for developers to receive freehold title to the land on a staged basis;
- the opportunity for developers to defer the acquisition and development of land over lengthy periods, subject to market demand;
- the ability of developers to deal with a single co-ordinating public sector agency which is solely focused on the promotion of the redevelopment of the Docklands;
- provision of trunk infrastructure by the State, including road works, the majority of which will be ultimately funded through the proceeds of certain land sales;
- packaging of land on a precinct basis which would provide developers with increased control of development within individual precincts, with less threat of competitive developments on adjacent land; and
- the State's acceptance of specified risks.

3.3.228 The redevelopment is being undertaken by the private sector through a competitive public bidding process. In this regard, the Authority placed significant importance on achieving best practice in its probity processes.

3.3.229 The Docklands is planned to be developed by each of the successful developers progressively to meet market demand. As part of the redevelopment, new road and pedestrian connections to the central business district and Spencer Street Station are being created to link Melbourne and the new waterfront comprising the Docklands.

Status of the development of the Docklands precincts

3.3.230 Table 3.3M outlines the current status of the agreed or proposed developments within each of the development precincts.

TABLE 3.3M
STATUS OF THE DOCKLANDS DEVELOPMENT PRECINCTS

Precinct	*Status*
Stadium	Development Agreement executed in September 1997 for construction over approximately 2 years of a multi-purpose sport and entertainment stadium incorporating a retractable roof. Proposals for the remainder of the Stadium precinct are at differing stages of negotiation, and include a variety of sport, entertainment, leisure, restaurant, office, accommodation and retail facilities. In addition, a conditional Development Agreement was executed in September 1998 for the establishment of the Seven Network digital broadcast centre which is to be located in the north-west corner of the precinct and is expected to be completed late in the year 2000.
Yarra Waters	Development Agreement executed in December 1997 for a 12 year development comprising approximately 2 000 apartments and townhouses, restaurants, marinas and commercial and retail areas.
Business Park	This precinct has been split into 2 developments. A conditional Development Agreement has been executed for a 2 year development comprising a theme park, working film studio, cinema megaplex and retail outlets. In addition, a separate Development Agreement has been finalised for a 14 year development comprising 1 800 residential dwellings, commercial office space, retail space and marina berths.
Victoria Harbour	A conditional Development Agreement was executed in October 1998, subject to satisfaction of key financial conditions and the satisfactory resolution of the remediation of the former West Melbourne Gasworks, for a 10 to 15 year development comprising approximately 2 500 apartments, commercial office space, retail complex, 360 hotel rooms and 450 serviced apartments.
Batman's Hill	The Grollo Tower Development Agreement for the precinct was terminated by the Authority on 10 April 1999. The Authority has advised that it has government approval to publicly re-offer the precinct in whole or in subdivided parts. The Authority aims to release an expression of interest document by June 1999. Work on relocating the heritage-registered Exhibition Goods Shed, which is located within the original boundaries of the Batman Hill precinct, commenced during February 1999. The Exhibition Goods Shed will be dismantled, labelled, packaged and then transported and rebuilt to house a tram museum for the Tramways Museum Society of Victoria in the township of Bylands, located 53 kilometres north of Melbourne.
Commonwealth Technology Port	Earlier proposals have not proceeded and seed funding of $22.5 million has now been provided by the Federal Government to assist in the establishment of a technology port. The Authority sought expressions of interest for the development, ownership and operation of the precinct in May 1999.
West End	The precinct is yet to be offered for development.

Previous Report to Parliament

3.3.231 The May 1998 *Report on Ministerial Portfolios* included comment on the progress made by the Docklands Authority on the redevelopment of the Docklands, including the process followed by the Authority for the selection of the developers of the Yarra Waters precinct and the benefits of the redevelopment for the State. In particular, the Report identified that:

- During December 1997, the Mirvac Group was announced as the successful developer for the Yarra Waters precinct of the Docklands redevelopment;
- Under the established arrangements, the developer has the option of not proceeding with individual stages of the development where there is insufficient market demand, or if it is considered not viable to do so. Accordingly, the full implementation of the development is dependent on market demand. However, the Authority may terminate the agreement and re-acquire any undeveloped land under certain circumstances;
- Where development stages relating to the Yarra Waters precinct proceed, the State will have access to certain revenue sharing arrangements but will not have a right to share in any profits achieved by the developer in excess of those anticipated. In response the Authority advised that it *chose a revenue share instead of a profit share because of its transparency and because this method diminishes the possibility of measurement disputes*; and
- In determining the preferred developers, the Docklands Authority decided not to assign any weighting to its evaluation criteria to signify the relative importance of the various criteria, which would have provided greater objectivity and transparency in the evaluation process. In response the Authority indicated that it was its *view, based on independent advice from international experts, that a pre-determined weightings approach was no longer in common use nor was it considered the best practice in complex competitive design tenders comparable to the project*.

3.3.232 This Report focuses on the results of a review of the arrangements established in relation to another stage of the development of the precincts, namely, the Docklands Stadium. Comments on these arrangements follow.

The Docklands Stadium

3.3.233 During October 1996, expressions of interest were invited for the development of a multi-purpose sport and entertainment stadium in the Stadium precinct. Following an evaluation of the expressions of interest received, 10 consortia were short-listed in December 1996 and invited to submit proposals for the financing and development of the stadium.

3.3.234 In March 1997, following the assessment of bids received, 4 developers were invited to prepare detailed proposals for the Stadium precinct, comprising the Stadium and the remainder of the precinct. The short-listed developers for the Technology Park and Batman's Hill precincts were also advised that they could bid for the remainder of the Stadium precinct or the northern or southern section, respectively.

3.3.235 The Authority's bid evaluation and negotiation process was outlined in the May 1998 *Report on Ministerial Portfolios*. While a similar process was followed in relation to the Stadium, the following evaluation criteria were considered as part of the evaluation process:

- design and amenity;
- integration;
- finance and risk considerations;
- viability;
- proposed quality of design and construction and program for construction and commissioning;
- proposed quality of management, operations, market attractiveness, competitiveness and maintenance and capital upgrade program; and
- other issues, including any risk or benefit to the State or the Authority flowing from the development.

3.3.236 Following a detailed evaluation of all proposals, in September 1997 the Docklands Stadium Consortium led by Baulderstone Hornibrook, KPMG, Merrill Lynch, Westpac, the Seven Network and News Ltd/HWT was announced as the successful bidder for the Stadium. Under the established arrangements:

- Stadium developer is Stadium Management Limited, comprising Stadium Operations Limited and National Mutual Trustees Limited;
- Construction contractor is Baulderstone Hornibrook;
- Stadium operator is Stadium Operations Limited, which is owned by several different shareholders;
- Stadium debt financier is Westpac leading a syndicate of debt facility providers;
- Stadium Manager is Stadium Management Limited which is owned by Stadium Operations Limited;
- Stadium Trustee is National Mutual Trustees Limited; and
- Venue manager is Nationwide Venue Management, a division of Spotless.

3.3.237 Construction of the facility commenced shortly thereafter and the Stadium is now scheduled to open in February 2000.

3.3.238 The Stadium will provide seating for 52 000 spectators with 98 per cent of seating being undercover for Australian Football League (AFL) matches when the roof is open. There will be extensive dining facilities comprising restaurants, cafes, bistros and bars to accommodate some 6 500 patrons. In addition, the Stadium has a closeable roof and retractable seating, making the venue suitable for large-scale concerts, a variety of sporting events and business conferences. There will be 66 corporate boxes to be leased and 2 500 car parking spaces under the Stadium for patrons.

3.3.239 Other key technical features of the Stadium include:

- 2 video screens and an outside "forthcoming events" screen;
- High-powered lighting systems suspended from the stadium roof to create never-ending daylight without the need for light towers;
- "Smart card" access providing a speedy and cashless means of paying for parking, gaining entry and buying food, beverages and souvenirs. Smart card integration is also being planned between the Stadium and other precincts; and
- Advanced acoustic design.

3.3.240 It is planned to have a variety of sporting entertainment and retail outlets fronting the concourse which encircles the Stadium, including a themed sports bar with dining, bistro and special function capability operating seven days a week.

Docklands Stadium under construction.

Development arrangements

3.3.241 Under the Development Agreement for the Stadium, the developer is required to complete the specified works in accordance with a schedule of milestones as set out in the Agreement. The original and current target dates for the major milestones for the development are set out in Table 3.3N

TABLE 3.3N
TARGET DATES FOR ACHIEVEMENT OF STADIUM DEVELOPMENT MILESTONES

Milestone	*Original date*	*Revised date*
Commencement of construction	23 November 1997	1 October 1997*(a)*
Completion of Stadium concrete structure	23 January 1999	23 February 1999*(a)*
Completion of main structural steel to fixed roof	30 June 1999	31 July 1999
Practical completion	31 December 1999	31 January 2000

(a) Actual date milestone achieved (with the exception of minor items).

3.3.242 The Table shows that the target dates for achievement of the milestones have not varied significantly since the Stadium Development Agreement was executed in September 1997.

Summary of the arrangements for the Stadium

3.3.243 **Overall, the Stadium arrangements require the State to provide trunk infrastructure valued at $61.5 million which will provide benefits for the whole of the Docklands but which is critical for the Stadium, and to provide 7.2 hectares of land. In addition, the State has accepted certain defined risks in order to facilitate private sector construction, financing and ownership of the Stadium. Ultimately, under the Stadium arrangements the State will receive $33.7 million from the private sector, not including the economic benefit to be derived from the Stadium development and operation.** Key aspects of the arrangements established for the development of the Stadium are set out in Table 3.3O.

TABLE 3.3O
OVERVIEW OF THE STADIUM ARRANGEMENTS

Key aspects	*Elaboration*
Land owned by the State is leased to the developer for a period of 25 years for a one-off payment of $3 million.	The cost of the lease to the developer comprises a lease premium of $3 million payable on or before the developer takes possession of the land, and an annual peppercorn rental of $1 over the term of the lease. The lease premium of $3 million has been received by the Authority.
The developer reimburses the State for the cost of site clearance works and certain consultancy costs amounting to $11.5 million.	Under the Development Agreement, the developer is required to reimburse the State for costs it has incurred in undertaking site clearance works and engaging consultants in connection with the Stadium.
The developer constructs and finances the Stadium at a cost of around $425 million.	The Developer is responsible for the financing and construction of the Stadium. In addition, the Development Agreement requires the developer to commit to spend 1 per cent of the total development cost on the development of internal and external public spaces and public art in consultation with the Authority.
The Authority has the right to gain ownership of the Stadium at the end of the 25 year lease period.	The lease arrangements provide for the ownership of the Stadium buildings to revert to the Authority upon expiration or sooner determination of the 25 year lease term. In addition, as part of the lease arrangements, the Authority has an irrevocable and assignable option, for a nominal fee of $1, to purchase the Stadium fixtures and fittings at the expiration of the lease term.
The Authority has responsibility for the construction of trunk infrastructure for the Docklands, elements of which will be critical for the Stadium.	The Authority has contracted for, and will pay for the construction of the trunk infrastructure for the Docklands. Trunk infrastructure which is critical for the Stadium includes, among other things, the Bourke Street pedestrian bridge, Spencer Street Station pedestrian subway, and the extension of La Trobe and Bourke Streets.
The developer provides finance of $29.1 million to the Authority which will contribute towards the cost of the construction of trunk infrastructure.	The Authority has exercised its right under the Development Agreement to request the developer to provide finance to the Authority of $29.1 million which will contribute towards the cost of the construction of trunk infrastructure. The Authority has advised that the estimated cost of the trunk infrastructure which is critical for the Stadium is $61.5 million as at 22 April 1999 and that infrastructure will provide benefits for the whole of the Docklands, including the Stadium precinct. This loan facility only becomes repayable under certain circumstances discussed later in this Report. The Authority's compliance with the requirements of the *Borrowings and Investment Powers Act* 1987 in respect of this transaction is also considered later in this Report.

TABLE 3.3O
OVERVIEW OF THE STADIUM ARRANGEMENTS - *continued*

Key aspects	*Elaboration*
The Australian Football League (AFL) may pay to the Authority a non-refundable Option Fee of $30 million, causing the Authority to make full repayment of the finance obtained from the developer for a sum of $28.4 million.	The Authority granted the AFL a right in the form of an Option to acquire ownership of the Stadium in light of its commitment to conduct football matches at the Stadium. If the AFL pays the non-refundable Option Fee of $30 million, the Authority will then be required to pay $28.4 million to the developer in full satisfaction of the funds lent to the Authority. The AFL's agreement to pay its Option Fee is conditional upon the construction of the Stadium by or before 31 December 2002. The AFL (with the approval of the Authority) can assign any of its rights under the Agreement. Other key aspects of the arrangements with the AFL are discussed later in this Report.
The AFL, having paid the Option Fee, may purchase the Stadium and associated land from the Authority for a nominal amount of $30 at the end of the lease term.	The AFL, after having paid the Option Fee on or before 31 December 2002, can exercise an Option to purchase the Stadium and associated land from the Authority for a nominal amount of $30 at the end of the 25 year lease term.
Should the AFL decide not to pay the Option Fee, the Stadium Trustee may exercise certain redress against the AFL and/or act to purchase the Stadium and associated land from the Authority for approximately $1.6 million.	If the AFL decides not to pay the Option Fee, the Stadium Trustee is deemed to have suffered a loss of an amount of not less than $30 million and can either seek legal or equitable remedy from the AFL and/or act on its option to acquire the freehold title of the Stadium. This later course of action occurs if the Stadium Manager pays an option fee of $1.6 million to the Authority on behalf of the Stadium Trustee. The Trustee can then purchase the freehold title to the Stadium and associated land within a 5 year period at a nominal cost of $30. The receipt of this option fee does not "trigger" a requirement for the Authority to repay its borrowing from the developer.
The State has accepted certain risks associated with the Stadium development.	The Authority and/or the State has accepted a number of risks from the development arrangements for the Stadium which are outlined later in this Report.

Borrowings and Investment Powers Act 1987

3.3.244 As indicated in the previous table, during the 1997-98 financial year the developer provided finance of $29.1 million to the Authority, pursuant to the Development Agreement. The *Borrowing and Investment Powers Act* 1987 which sets out the borrowing and investment powers of the Authority, requires the Authority to obtain the approval of the Treasurer prior to accepting such a loan. **However, audit noted that as at March 1998 the Authority had not obtained the required prior formal approval from the Treasurer for the loan, as required under the Act.** Subsequently, the Authority initiated procedures to resolve this matter, however, at the date of preparation of this Report, this matter remained outstanding. The Authority advised that documentation is expected to be completed shortly to resolve this matter. It is also the view of the Authority that the failure to obtain this approval has no legal effect on the validity of the loan nor carries any other sanction.

Associated arrangements

3.3.245 To enhance the development prospects of the new Stadium, in April 1997, as part of the arrangements for the development, the Authority entered into a user agreement with the AFL. It was intended that the successful developer would be substituted for the Authority as a party to the AFL User Agreement, with any subsequent amendments to that Agreement only requiring the agreement of the successful developer and the AFL.

3.3.246 Under these arrangements, established with the AFL in relation to the Stadium over a period of several years from the date of practical completion of the Stadium, among other things, the AFL had agreed to:

- Conduct a minimum number of football matches at the Stadium. At least 30 AFL matches will be played each year at the Stadium;
- Share certain revenue from AFL matches held at the Stadium with the developer;
- Treat and promote the Stadium as one of the principal venues for AFL matches in Victoria;
- An exclusive right to licence broadcasters via television, radio or other technology, for each AFL event at the Stadium;
- Certain signage rights; and
- Maintain certain public risk insurance in respect of all AFL events.

3.3.247 Audit understands that amendments have been made to the AFL User Agreement.

3.3.248 Also under the arrangements with the Stadium Developer and the AFL, all rights of Crown Casino Limited in respect of a car park lease over part of the Stadium site were required to be extinguished. While a dispute existed as to the rights of Crown Casino Limited, a Deed of Surrender and Release was executed during August 1997 to resolve the dispute between Crown Casino Limited, and the Authority and the Public Transport Corporation. The Deed provided for the Authority to pay to the Public Transport Corporation half of Crown Casino Limited's additional rental payments under the lease for approximately 6 months and to grant a licence to Crown Casino Limited to rent other land in the Docklands area and for Crown Casino Limited to cease occupation of the car park site. The licence to use certain other areas within the Docklands area for car parking provides for the setting of an annual fee with the licence renewable on an annual basis up to the year 2007. The Authority advised that it received the improvements on the land and operated the car park for more than 12 months, which generated revenue in excess of the amount paid to the Public Transport Corporation.

Key risks borne by the State

3.3.249 The bid documents issued by the Authority for the Stadium set out the major risks associated with the development and detailed how these risks could be allocated between the developers and the State. A number of risks were allocated either wholly or partly to the State, while all other risks were allocated to the developer. Among the risks allocated to the developer were those related to the bid preparation, evaluation and negotiation phases, and the financing, construction and post-construction phases of the development.

3.3.250 Key risks allocated to the State, as incorporated into the agreed development arrangements for the Stadium include:

- *The developer's preferred rating regime* - The Authority is required to make an annual payment to the developer where the developer's preferred local government, sewerage and water rating regime is not introduced. This payment represents the difference between the value of the actual rates paid by the developer and the rates that would have been payable under the developer's preferred rating regime, where the value of the difference is greater than $100 000 each financial year. The developer's preferred rating regime is a commercial rate set by reference to the services being provided and not calculated by reference to the improved or unimproved capital value of the land.

  The Authority has advised that it has reached agreement with the Department of Treasury and Finance on the form of a rate exemption to be approved by the Treasurer to introduce the developer's preferred rating regime. However, at the date of preparation of this Report, the Authority had not received the Treasurer's approval for the rate exemption due to minor changes to the form of the exemption being requested by the developer which were still under consideration. The Authority has, pursuant to the *Local Government (Governance and Melton) Act* 1998, assumed municipal governance of the Docklands area and, accordingly, will be responsible for charging and collecting municipal rates in respect of the Docklands area. The Authority has advised that it will work with the developer to establish the preferred rating scheme by the opening of the Stadium.

- *Construction, development or improvement of other venues by the State or any government agency* - Compensation is required to be paid by the Authority to the developer where the State or any government agency constructs, develops or improves other venues, or the Government provides financial assistance of greater than $1 million to a Stadium of 20 000 seats or more within 10 kilometres of the Melbourne General Post Office which results in the revenue derived by the developer being reduced by an amount greater than $100 000 in any financial year, up to 31 December 2009. Venues excluded from this provision comprise the Melbourne Cricket Ground, Melbourne Park Tennis Centre, Olympic Park, Flemington Racecourse and any other temporary venue developed for the Commonwealth Games. At the time of preparation of this Report, the Authority was not aware of any developments that would "trigger" this requirement.

- *Variation to the State Environment Protection Policy* - The Authority was required to pay the developer liquidated damages should it have been unable to obtain a variation of the State Environment Protection Policy to allow for increased noise levels by the later of 31 December 1999 or the Stadium's date of practical completion. The Authority advised that the required variation to the State Environment Protection Policy (Control of Music And Noise From Public Premises) was gazetted on 25 March 1999.

- *Project specific legislation risk* - The Authority is required to compensate the developer for any reduction in revenue over $100 000 each financial year resulting from the enacting of other project specific legislation subsequent to the date of the Agreement.

- *Industrial relations risk* - The Authority assumes all risks in relation to site specific legislation which affects industrial relations in respect of the project.
- *Land/site risk* - This is the risk that the developer cannot be granted appropriate title to the land or any required access rights.
- *Changes in boundaries, plans and specifications risk* - This risk relates to the impact of any change in precinct boundaries or to final plans and specifications initiated by the Authority, a government agency or the State generally.
- *Governing law and jurisdiction, residence of developer risk* - This is the risk that the enforcement of important contractual obligations against foreign developers (and other parties):
    - will be governed by legal systems which are ineffective, slower, more expensive or less predictable than what local parties are accustomed to; or
    - will be difficult because the developer (or other party) is not a resident of Australia.

3.3.251 The maximum liability to the State for the risks associated with the failure to establish the developer's preferred rating arrangement or where the State or a government agency constructs or provides financial assistance for the development of other venues as outlined above, is capped in aggregate at an amount of $10 million for all claims for compensation.

SCHEDULE A
STATUS OF MATTERS RAISED IN PREVIOUS REPORTS

Report	*Subject*	*Status at date of preparation of this Report*
	MATTERS RESOLVED OR ACTION COMMENCED	
LOCAL GOVERNMENT		
Ministerial Portfolios, May 1998, pp. 110-113	The use of audit committees and internal audit had not been universally adopted across the local government sector and, as a consequence, corporate governance within the sector had been diminished.	The Local Government Branch of the Department of Infrastructure in conjunction with the local government sector has developed *best practices* guidelines for the operation of audit committees and internal audit in local government entities. Further comment on this matter is provided in this Report.
Ministerial Portfolios, May 1998, pp. 114-120	A survey in the 1996-97 financial year of the management of municipal business undertakings indicated that 12 councils were unable to identify surpluses or losses generated from their business unit operations, covering contract expenditure in excess of $68 million.	The Department's Local Government Branch in conjunction with the local government sector has developed a *best practice* guideline for internal and external financial reporting by councils on business unit financial performance and major contracts. Further comment on this matter is provided in this Report.
Ministerial Portfolios, May 1998, pp. 121-127	A review of road maintenance services relating to the Macedon Ranges Shire Council identified scope for councils to improve tender and contract management processes.	The Department's Local Government Branch plans to establish a reference group comprising of municipalities which prepare tender specifications for road works, members of peak industry groups and independent expert consultants. The key objective of the reference group will be to develop *best practice* guidelines by 30 September 1999.
Ministerial Portfolios, May 1998, pp 128-130	An unsuccessful tenderer issued a writ in the Victorian Supreme Court against the City of Greater Dandenong seeking damages for the Council rejecting the tenderer's bid of $7.23 million in favour of a bid of $8.99 million lodged by an in-house service provider.	The council and the external tenderer entered into a Terms of Settlement agreement on 30 April 1999 in which Council agreed to pay the external tenderer a settlement sum of $100 000 inclusive of legal costs and disbursements. In addition, the council has advised audit that based on current projections the final cost of the related contracts are estimated to be only $50 000 more than the price submitted by the external tenderer.

SCHEDULE A
STATUS OF MATTERS RAISED IN PREVIOUS REPORTS

Report	*Subject*	*Status at date of preparation of this Report*
	NO ACTION TAKEN	
DOCKLANDS AUTHORITY		
Ministerial Portfolios, May 1998, pp. 87 - 103	In determining the preferred developers for the Yarra Waters precinct, the Docklands Authority decided not to assign any weighting to its evaluation criteria to signify the relative importance of the various criteria, which would have provided greater objectivity and transparency in the evaluation process.	Comment on further stages of the redevelopment of the Docklands is provided in this Report.
PUBLIC TRANSPORT		
Ministerial Portfolios, May 1989, p. 236.	The adequacy and quality of disclosure within the financial reports of the transport authorities is inadequate as financing costs related to centralised debt are not included.	Position unchanged. Finance costs are reported centrally by the Government.
Ministerial Portfolios, May 1997, p. 121.	The Department of Infrastructure has not performed a post-implementation review of the contracting-out of the Melbourne to Warrnambool and Melbourne to Cobram services and, accordingly, there is a possibility that the experiences gained from these arrangements may not be factored into future privatisation proposals.	Position unchanged.

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 Infrastructure	30 June 1998	31 Oct. *Financial Management Act* 1994, s.46.	31 Aug. 1998	4 Sept. 1998
ROADS AND PORTS				
Marine Board of Victoria	30 June 1998	" "	29 Sept. 1998	5 Oct. 1998
Roads Corporation	30 June 1998	" "	31 Aug. 1998	31 Aug. 1998
TRANSPORT				
Public Transport Corporation	30 June 1998	" "	11 Sept. 1998	11 Sept. 1998
PLANNING AND LOCAL GOVERNMENT				
Architects Registration Board of Victoria	30 June 1998	" "	13 Oct. 1998	27 Oct. 1998
Building Control Commission	30 June 1998	" "	5 Aug. 1998	6 Aug. 1998
Docklands Authority	30 June 1998	" "	28 Sept. 1998	28 Sept. 1998
Heritage Council	30 June 1998	" "	2 Oct. 1998	6 Oct. 1998
Melbourne City Link Authority	30 June 1998	" "	25 Aug. 1998	25 Aug. 1998
Plumbing Industry Board *(a)*	Period 24 Mar. 1997 to 30 June 1998	" "	11 Sept. 1998	24 Sept. 1998
Urban Land Corporation *(b)*	30 June 1998	" "	14 Sept. 1998	14 Sept. 1998

SCHEDULE B
COMPLETED/INCOMPLETE AUDITS - *continued*

Entity	*Financial year ended*	*Reporting to Minister for Planning and Local Government*	*Financial statements signed by entity*	*Auditor-General's report signed*
		COMPLETED AUDITS - *continued*		
PLANNING AND LOCAL GOVERNMENT *- continued*				
Alpine Shire Council	30 June 1998	30 Sept. *Local Government Act* 1989, s.126.	13 Oct. 1998	14 Oct. 1998
Ararat Rural City Council	30 June 1998	" "	11 Sept. 1998	15 Sept. 1998
Ballarat City Council	30 June 1998	" "	9 Oct. 1998	9 Oct. 1998
Banyule City Council	30 June 1998	" "	21 Sept. 1998	24 Sept. 1998
Bass Coast Shire Council	30 June 1998	" "	28 Sept. 1998	28 Sept. 1998
Baw Baw Shire Council	30 June 1998	" "	11 Sept. 1998	17 Sept. 1998
Bayside City Council	30 June 1998	" "	23 Sept. 1998	28 Sept. 1998
Boroondara City Council	30 June 1998	" "	14 Sept. 1998	15 Sept. 1998
Brimbank City Council	30 June 1998	" "	23 Sept. 1998	30 Sept. 1998 *(c)*
Buloke Shire Council	30 June 1998	" "	22 Sept. 1998	30 Sept. 1998
Campaspe Shire Council	30 June 1998	" "	17 Sept. 1998	18 Sept. 1998
Cardinia Shire Council	30 June 1998	" "	17 Sept. 1998	22 Sept. 1998
Casey City Council	30 June 1998	" "	23 Sept. 1998	24 Sept. 1998
Casey - Cardinia Regional Library Corporation	30 June 1998	" "	24 Sept. 1998	24 Sept. 1998
Central Highlands Regional Library Corporation	30 June 1998	" "	28 Sept. 1998	30 Sept. 1998
Central Goldfields Shire Council	30 June 1998	" "	17 Sept. 1998	23 Sept. 1998
CityWide Service Solutions Pty Ltd	30 June 1998	" "	25 Sept. 1998	25 Sept. 1998
Colac-Otway Shire Council	30 June 1998	" "	14 Oct. 1998	14 Oct. 1998

SCHEDULE B
COMPLETED/INCOMPLETE AUDITS - *continued*

Entity	*Financial year ended*	*Reporting to Minister for Planning and Local Government*	*Financial statements signed by entity*	*Auditor-General's report signed*
		COMPLETED AUDITS - *continued*		
PLANNING AND LOCAL GOVERNMENT - *continued*				
Corangamite Shire Council	30 June 1998	30 Sept. *Local Government Act* 1989, s.126.	28 Sept. 1998	29 Sept. 1998
Corangamite Regional Library Corporation	30 June 1998	" "	4 Sept. 1998	30 Sept. 1998
Darebin City Council	30 June 1998	" "	11 Sept. 1998	11 Sept. 1998
Delatite Shire Council	30 June 1998	" "	14 Sept. 1998	30 Sept. 1998
East Gippsland Shire Council	30 June 1998	" "	21 Sept 1998	24 Sept. 1998
Eastern Regional Library Corporation	30 June 1998	" "	29 Sept. 1998	30 Sept. 1998
Frankston City Council	30 June 1998	" "	25 Sept. 1998	28 Sept. 1998
Gannawarra Shire Council	30 June 1998	" "	31 Aug. 1998	4 Sept. 1998
Geelong Regional Library Corporation	30 June 1998	" "	25 Sept. 1998	26 Sept. 1998
Glen Eira City Council	30 June 1998	" "	28 Sept. 1998	30 Sept. 1998
Glenelg Shire Council	30 June 1998	" "	29 Sept. 1998	30 Sept. 1998
Glenelg Regional Library Corporation	30 June 1998	" "	30 Sept. 1998	5 Oct. 1998
Golden Plains Shire Council	30 June 1998	" "	28 Sept. 1998	29 Sept. 1998
Goulburn Valley Regional Library Corporation	30 June 1998	" "	28 Sept. 1998	30 Sept. 1998
Greater Bendigo City Council	30 June 1998	" "	29 Sept. 1998	29 Sept. 1998 *(c)*
Greater Dandenong City Council	30 June 1998	" "	18 Sept. 1998	24 Sept. 1998
Greater Geelong City Council	30 June 1998	" "	22 Sept. 1998	24 Sept. 1998
Greater Shepparton City Council	30 June 1998	" "	28 Sept. 1998	30 Sept. 1998

SCHEDULE B
COMPLETED/INCOMPLETE AUDITS - *continued*

Entity	*Financial year ended*	*Reporting to Minister for Planning and Local Government*	*Financial statements signed by entity*	*Auditor-General's report signed*
COMPLETED AUDITS - *continued*				
PLANNING AND LOCAL GOVERNMENT *- continued*				
Hepburn Shire Council	30 June 1998	30 Sept. *Local Government Act* 1989, s.126.	25 Sept. 1998	25 Sept. 1998
High Country Regional Library Corporation	30 June 1998	" "	10 Sept. 1998	17 Sept. 1998
Hindmarsh Shire Council	30 June 1998	" "	7 Oct. 1998	14 Oct. 1998
Hobsons Bay City Council	30 June 1998	" "	28 Sept. 1998	30 Sept. 1998
Horsham Rural City Council	30 June 1998	" "	5 Oct. 1998	8 Oct. 1998
Hume City Council	30 June 1998	" "	29 Sept. 1998	30 Sept. 1998
Hume-Moonee Valley Regional Library Corporation	30 June 1998	" "	15 Oct. 1998	20 Oct. 1998
Indigo Shire Council	30 June 1998	" "	14 Sept. 1998	15 Sept. 1998
Kingston City Council	30 June 1998	" "	23 Sept. 1998	30 Sept. 1998
Knox City Council	30 June 1998	" "	22 Sept. 1998	23 Sept. 1998
La Trobe Shire Council	30 June 1998	" "	14 Sept. 1998	18 Sept. 1998
Loddon Shire Council	30 June 1998	" "	14 Sept. 1998	18 Sept. 1998
Macedon Ranges Shire Council	30 June 1998	" "	28 Sept. 1998	30 Sept. 1998
Manningham City Council	30 June 1998	" "	22 Sept. 1998	24 Sept. 1998
Maribyrnong City Council	30 June 1998	" "	28 Sept. 1998	1 Oct. 1998
Maroondah City Council	30 June 1998	" "	28 Sept. 1998	30 Sept. 1998
Melbourne City Council	30 June 1998	" "	25 Sept. 1998	25 Sept. 1998
Melbourne Wholesale Fish Market Pty Ltd	30 June 1998	" "	15 Sept. 1998	23 Sept. 1998
Melton Shire Council	30 June 1998	" "	28 Sept. 1998	30 Sept. 1998

SCHEDULE B
COMPLETED/INCOMPLETE AUDITS - *continued*

Entity	*Financial year ended*	*Reporting to Minister for Planning and Local Government*	*Financial statements signed by entity*	*Auditor-General's report signed*
		COMPLETED AUDITS - *continued*		
PLANNING AND LOCAL GOVERNMENT - *continued*				
Mildura Rural City Council	30 June 1998	30 Sept. *Local Government Act* 1989, s.126.	23 Sept. 1998	28 Sept. 1998
Mitchell Shire Council	30 June 1998	" "	14 Sept. 1998	16 Sept. 1998
Moira Shire Council	30 June 1998	" "	26 Oct. 1998	30 Oct. 1998 *(c)*
Monash City Council	30 June 1998	" "	25 Sept. 1998	25 Sept. 1998
Moonee Valley City Council	30 June 1998	" "	23 Sept. 1998	24 Sept. 1998
Moorabool Shire Council	30 June 1998	" "	22 Sept. 1998	25 Sept. 1998
Moreland City Council	30 June 1998	" "	16 Sept. 1998	18 Sept. 1998
Mornington Peninsula Shire Council	30 June 1998	" "	5 Oct. 1998	8 Oct. 1998
Mount Alexander Shire Council	30 June 1998	" "	13 Oct. 1998	16 Oct. 1998
Moyne Shire Council	30 June 1998	" "	16 Oct. 1998	26 Oct. 1998
Murrundindi Shire Council	30 June 1998	" "	28 Oct. 1998	30 Oct. 1998
Nillumbik Shire Council	30 June 1998	" "	23 Sept. 1998	25 Sept. 1998
North Central Goldfields Regional Library Corporation	30 June 1998	" "	29 Sept. 1998	30 Sept. 1998
Northern Grampians Shire Council	30 June 1998	" "	29 Sept. 1998	30 Sept. 1998
Port Phillip City Council	30 June 1998	" "	24 Sept. 1998	25 Sept. 1998
Prahran Market Pty Ltd	30 June 1998	" "	29 Sept. 1998	29 Sept. 1998
Pyrenees Shire Council	30 June 1998	" "	23 Sept. 1998	30 Sept. 1998
Queenscliffe Borough Council	30 June 1998	" "	23 Sept. 1998	29 Sept. 1998
Queen Victoria Market Pty Ltd	30 June 1998	" "	15 Sept. 1998	23 Sept. 1998

SCHEDULE B
COMPLETED/INCOMPLETE AUDITS - *continued*

Entity	*Financial year ended*	*Reporting to Minister for Planning and Local Government*	*Financial statements signed by entity*	*Auditor-General's report signed*
COMPLETED AUDITS - *continued*				
PLANNING AND LOCAL GOVERNMENT *- continued*				
Regent Management Company Pty Ltd	30 June 1998	30 Sept. *Local Government Act* 1989, s.126.	23 Dec. 1998	24 Dec. 1998
South Gippsland Shire Council	30 June 1998	" "	15 Oct. 1998	16 Oct. 1998
Southern Grampians Shire Council	30 June 1998	" "	29 Sept. 1998	30 Sept. 1998
Stonnington City Council	30 June 1998	" "	25 Sept. 1998	29 Sept. 1998
Strathbogie Shire Council	30 June 1998	" "	21 Sept. 1998	28 Sept. 1998
Surf Coast Shire Council	30 June 1998	" "	28 Sept. 1998	30 Sept. 1998
Swan Hill Rural City Council	30 June 1998	" "	22 Sept. 1998	30 Sept. 1998
Swan Hill Regional Library Corporation	30 June 1998	" "	29 Sept. 1998	5 Oct. 1998
Towong Shire Council	30 June 1998	" "	21 Sept. 1998	24 Sept. 1998
Wangaratta Rural City Council	30 June 1998	" "	10 Sept. 1998	15 Sept. 1998
Warrnambool City Council	30 June 1998	" "	28 Sept. 1998	30 Sept. 1998
Wellington Shire Council	30 June 1998	" "	9 Sept. 1998	18 Sept. 1998
West Wimmera Shire Council	30 June 1998	" "	29 Sept. 1998	2 Oct. 1998
West Gippsland Regional Library Corporation	30 June 1998	" "	22 Sept. 1998	29 Sept. 1998 *(c)*
Whitehorse City Council	30 June 1998	" "	29 Sept. 1998	30 Sept. 1998
Whitehorse Manningham Regional Library Corporation	30 June 1998	" "	28 Sept. 1998	30 Sept. 1998
Whittlesea City Council	30 June 1998	" "	29 Sept. 1998	1 Oct. 1998
Wimmera Regional Library Corporation	30 June 1998	" "	5 Oct. 1998	9 Oct. 1998
Wodonga Rural City Council	30 June 1998	" "	14 Sept. 1998	15 Sept. 1998

SCHEDULE B
COMPLETED/INCOMPLETE AUDITS - *continued*

Entity	*Financial year ended*	*Reporting to Minister for Planning and Local Government*	*Financial statements signed by entity*	*Auditor-General's report signed*
COMPLETED AUDITS - *continued*				
PLANNING AND LOCAL GOVERNMENT *- continued*				
Wyndham City Council	30 June 1998	30 Sept. *Local Government Act* 1989, s.126.	28 Sept. 1998	29 Sept. 1998
Yarra City Council	30 June 1998	" "	22 Oct. 1998	23 Oct. 1998
Yarra Ranges Shire Council	30 June 1998	" "	29 Sept. 1998	29 Sept. 1998
Yarra Plenty Regional Library Corporation	30 June 1998	" "	24 Sept. 1998	30 Sept. 1998
Yarra-Melbourne Regional Library Corporation	30 June 1998	" "	28 Sept. 1998	28 Sept. 1998
Yarriambiack Shire Council	30 June 1998	" "	29 Sept. 1998	30 Sept. 1998

(a) Formerly known as the Plumbers, Gasfitters and Drainers Registration Board.

(b) Previously known as the Urban Land Authority.

(c) Qualified audit report issued.

Part 3.4

Justice

KEY FINDINGS

Victoria Legal Aid - Funding changes

- While Commonwealth funding for legal aid declined between the 1996-97 and 1998-99 financial years, State Government funding has remained constant.

  Paras 3.4.8 to 3.4.16

- In the absence of additional State funding, Victoria Legal Aid (VLA) estimates that it will experience an overall funding shortfall of approximately $4 million in the 1998-99 financial year.

  Paras 3.4.8 to 3.4.16

- Although VLA had no control over the Commonwealth Government decision to reduce legal aid funding, the impact of the decision was to reduce the community's access to legal aid, which is in direct conflict with one of VLA's primary objectives of providing the community with improved access to justice and legal remedies.

  Paras 3.4.21 to 3.4.24

- The audit review of a sample of legal aid applications revealed that, generally, there was no evidence on client files to support the decisions made regarding the merits test. As a result, audit was unable to determine whether all aspects of the Commonwealth and State merits tests had been appropriately applied.

  Paras 3.4.36 to 3.4.47

- VLA should undertake an assessment of need for legal aid within the Victorian community to assist it in allocating scarce legal aid funding in the most effective and equitable manner, and to determine the impact of changes to legal aid guidelines on the provision of legal aid services in Victoria.

  Paras 3.4.57 to 3.4.62

- VLA considers that the additional funding of $4 million for the 1999-2000 year, announced in the State Budget, will address the anticipated shortfall in funding for State law cases in that year.

  Paras 3.4.8 to 3.4.16

KEY FINDINGS - *continued*

Urgent need for enhanced public accountability covering non-judicial functions of Victorian courts

- I have been forced to curtail the scope of several audits of administrative functions within judicial bodies since June 1996 because of legal advice provided to the Department at the time of my proposed tabling of the Children's Court performance audit.

Paras 3.4.83 to 3.4.84

- The developments that have transpired on this matter are totally unsatisfactory in terms of the serious public accountability implications to the Parliament and the community.

Paras 3.4.85 to 3.4.87

- No other Auditor-General in Australasia has experienced the circumstances prevailing in Victoria on the audit of non-judicial activities of courts.

Paras 3.4.88 to 3.4.94

- The Government should move to present to Parliament as quickly as possible amendments to the audit legislation which assign to the Auditor-General the power to audit the administrative or non-judicial functions of all judicial bodies in Victoria.

Paras 3.4.95 to 3.4.99

3.4.1 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.

3.4.2 Details of the specific ministerial responsibilities for public bodies within the Justice sector are provided in Table 3.4A. These public bodies, together with the Department of Justice, were subject to audit by the Auditor-General during the 1997-98 financial year.

TABLE 3.4A
MINISTERIAL RESPONSIBILITIES
FOR PUBLIC BODIES WITHIN THE JUSTICE SECTOR

Ministerial portfolio	*Entities subject to audit*
Attorney-General	Equal Opportunity Commission Legal Practice Board Office of the Director of Public Prosecutions Office of the Legal Ombudsman Office of the Public Advocate Queen Victoria Women's Centre Trust Senior Master of the Supreme Court Victoria Legal Aid Victorian Electoral Commission Victorian Financial Institutions Commission Victorian Institute of Forensic Medicine
Police and Emergency Services	Country Fire Authority Metropolitan Fire Brigades Board National Institute for Forensic Science National Police Ethnic Advisory Bureau Office of the Chief Commissioner of Police
Fair Trading	-
Women's Affairs	-
Corrections	-

3.4.3 Comment on matters of significance arising from the audit of entities within the Justice sector is provided below.

VICTORIA LEGAL AID - FUNDING CHANGES

3.4.4 Victoria Legal Aid (VLA) was established on 14 December 1995 under the *Legal Aid Commission (Amendment) Act* 1995 as the successor body of the Legal Aid Commission of Victoria. The key objectives of VLA are to:

- provide legal aid in the most effective, economical and efficient manner;
- manage its resources to make legal aid available at a reasonable cost and on an equitable basis throughout the State;
- provide the community with improved access to justice and legal remedies; and
- pursue innovative means of providing legal aid which is directed at minimising the need for individual legal services in the community.

3.4.5 Legal aid is provided by VLA to disadvantaged members of the community who cannot afford to pay the full cost of legal services and may involve the provision of legal advice (including education services), preparation of legal documents, or legal representation in relation to proceedings before a court or tribunal.

3.4.6 VLA provides legal representation for a range of matters involving criminal, family and civil law. Applications for assistance are submitted individually, or by private practitioners on behalf of their clients, and if approved are assigned to either a VLA solicitor or a private practitioner. In the 1997-98 financial year, 68 per cent of grants made by VLA were to private practitioners, with independent counsel also used on internally provided legal services.

3.4.7 From its inception, VLA was intended to operate as a business-like corporate body. As a result, one of its first priorities on its establishment was to address a $6.4 million cash deficit it inherited from the former Legal Aid Commission of Victoria, and to ensure it operated within its legal aid budget.

Defendant appearing before a magistrate.
(Photo courtesy of Cinemedia and Victoria Legal Aid.)

Reduction in Commonwealth Government funding

3.4.8 Prior to 1 July 1997, the Commonwealth Government contributed 55 per cent of VLA's government funding, which VLA was able to distribute in accordance with its own priorities. However, in June 1996, the Commonwealth Attorney-General announced a decision to re-negotiate the arrangements for the provision of legal aid funding to States and Territories as from 1 July 1997. The proposed changes to the funding arrangements were designed to reduce Commonwealth legal aid expenditure by largely limiting it to cases involving Commonwealth law.

3.4.9 In order to determine an appropriate level of Commonwealth legal aid funding, the Commonwealth Government undertook an assessment of funding provided by it during the 1994-95 financial year, which had been applied by States and Territories to matters arising under Commonwealth law. This assessment indicated that approximately $33 million in Commonwealth funding for legal aid had been applied to State and Territory law matters. As a consequence, the Commonwealth reduced its total legal aid funding for the 1997-98 financial year to $106.6 million, representing a reduction of 23.6 per cent from the previous year's funding of $131.6 million.

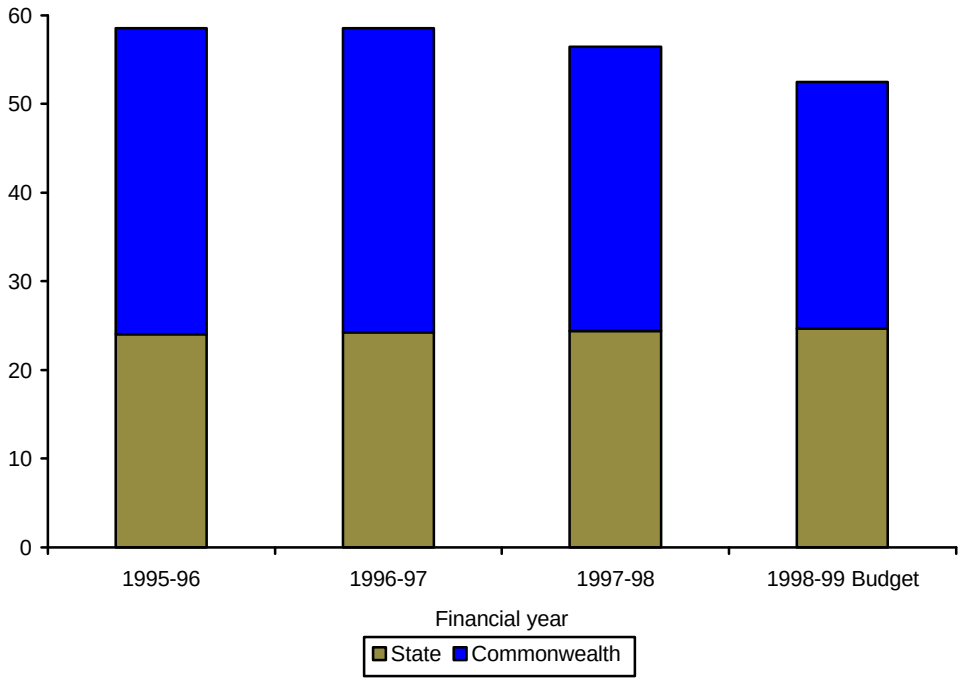
3.4.10 Under the new arrangements, Commonwealth Government funding is restricted to either cases arising under Commonwealth law, which comply with Commonwealth Government priorities and guidelines, or cases arising under State law for which the Commonwealth has accepted responsibility and where the subject matter represents a priority of the Commonwealth Government.

3.4.11 The initial funding agreement, between the Commonwealth Government and Victoria which covered the period from 1 July 1997 to 30 June 1998, was formulated in November 1997 and a further agreement for the following 2 years, which was negotiated directly with VLA, was formulated in January 1999.

3.4.12 The Commonwealth Government initially allocated funding of $29 million per annum to VLA for the financial years of 1997-98 to 1999-2000, however, following consultation between the Commonwealth and Victorian Governments, this amount was increased to $31.5 million for the 1997-98 financial year, with funding for the 1998-99 and 1999-2000 financial year reduced to $27.75 million. This new funding arrangement resulted in a decrease in Commonwealth funding to VLA of approximately 6.5 per cent in the 1997-98 financial year and 21.8 per cent over the following 2 years. Under the arrangements, VLA was permitted to apply $4.72 million and $2.75 million of its Commonwealth funding to State law matters in the 1997-98 and 1998-99 financial years, respectively.

3.4.13 Funding provided to VLA by the State and Commonwealth Governments over the past 3 years is depicted in Chart 3.4B.

CHART 3.4B
VLA FUNDING BY STATE AND COMMONWEALTH GOVERNMENTS, 1995-96 TO 1998-99
($million)



3.4.14 **Chart 3.4B illustrates that, while Commonwealth funding for legal aid has declined between the 1996-97 and 1998-99 financial years, State Government funding has remained constant.**

3.4.15 **The audit examination further identified in relation to the 1997-98 financial year that VLA expended all legal aid funding provided by the State Government, but did not expend $4 million of the $31.5 million of Commonwealth Government funding received for that year. This funding was not expended as VLA considered that there were insufficient applications satisfying the Commonwealth guidelines to justify spending the full $31.5 million during the year. Nevertheless in the absence of additional State funding, VLA estimates that it will experience an overall funding shortfall of approximately $4 million in the 1998-99 financial year.**

3.4.16 **VLA considers that the additional funding of $4 million for the 1999-2000 year, announced in the State Budget, will address the anticipated shortfall in funding for State law cases in that year.**

Response to reduced Commonwealth Government funding

3.4.17 Faced with an accumulated funding deficit from the former Victorian Legal Aid Commission and a significant decrease in Commonwealth Government funding from 1 July 1997, the management of VLA was faced with the need to address a difficult financial position. Without a significant reduction in its operating expenditure, the lower Commonwealth funding had the potential to seriously compromise the financial viability of the VLA. In this regard, the changes to the provision of legal aid in Victoria, which resulted in the creation of VLA, were designed to curtail some of the unsustainable expenditure incurred by the former Commission and to reduce the perceived excessive costs of legal practitioners engaged.

3.4.18 The above concerns regarding the financial viability to legal aid services in Victoria were also shared by the Victorian and Commonwealth Governments, which in 1994 established a joint inquiry to review the delivery of these services. In the November 1993 report to the Parliament on the operations of the Legal Aid Commission of Victoria my Office also concluded that the financial management of VLA required improvement.

3.4.19 In response to these issues, VLA implemented a number of initiatives to reduce the cost of its legal aid grants to the community, including:

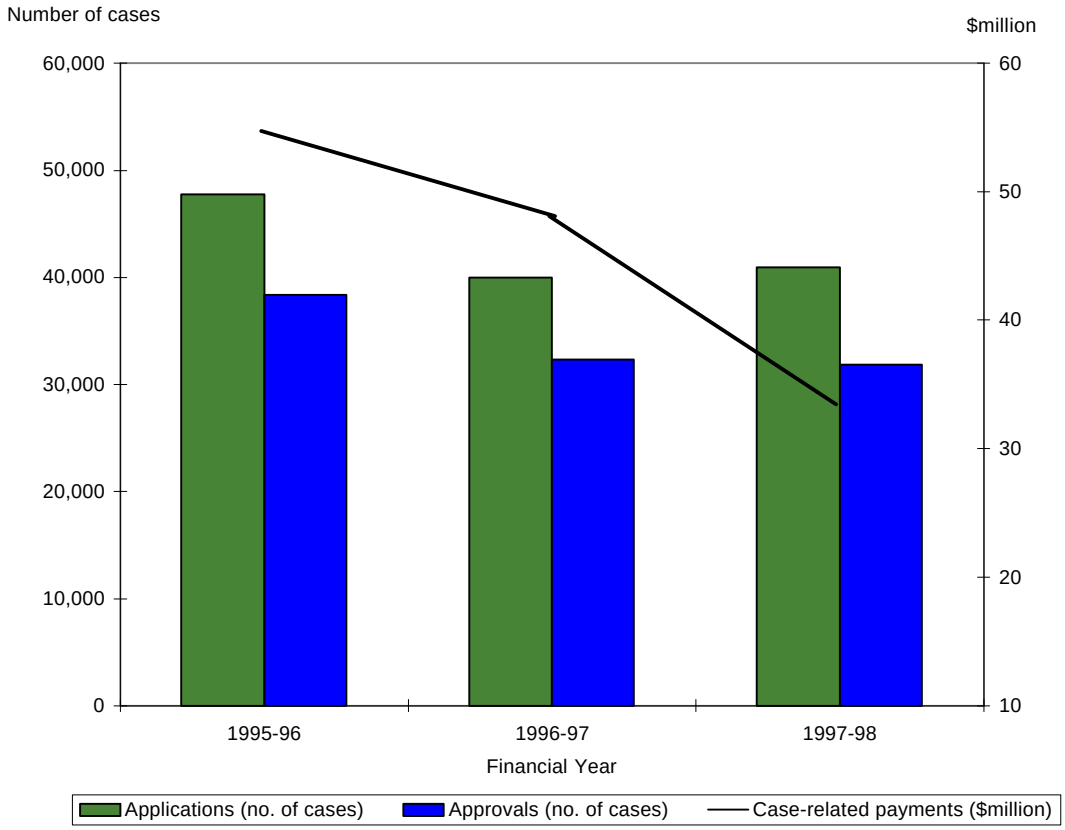
- imposition of fee ceilings on family and criminal law matters, effective from October 1996;
- termination of some family law assistance where the funding cap had already been exceeded; and
- amending of guidelines for grants in State law matters.

3.4.20 VLA's objective in amending the guidelines associated with the granting of legal aid assistance was to contain the cost of legal services and to spread its limited legal aid resources over a greater number of cases.

Impact of initiatives on VLA's operations

3.4.21 As illustrated in Chart 3.4C and acknowledged in VLA's *1996-97 Annual Report*, the introduction of the above initiatives in the 1996-97 financial year was largely responsible for the significant decrease in the number of applications received for grants of assistance, grant approvals and case related payments, which decreased by 14.3 per cent, 17.1 per cent and 38.6 per cent, respectively, between the 1995-96 and 1997-98 financial years.

CHART 3.4C
VLA LEGAL AID APPLICATIONS AND APPROVALS



Source: Victoria Legal Aid, Annual Report, 1997-98, page 7.

3.4.22 The most significant decrease in legal aid applications (20 per cent reduction in the period 1995-96 to 1997-98) was experienced in the area of civil law and resulted primarily from the introduction of conditional fees in the *Legal Practice Act* 1996 and changes to VLA guidelines which reduced the scope for cases to be funded by VLA. In particular, amendments to the Act introduced the "no win no pay" scheme for solicitors, which enable individuals to pay for legal representation only where they were successful in court. As a result of this change, VLA decided to significantly reduce funding in this area, which in turn resulted in a significant reduction in funding applications for civil law matters.

3.4.23 Reductions of 18.7 per cent and 11.6 per cent were experienced in family law and criminal law applications respectively for the period 1995-96 to 1997-98 as a result of the implementation of the previously-mentioned initiatives.

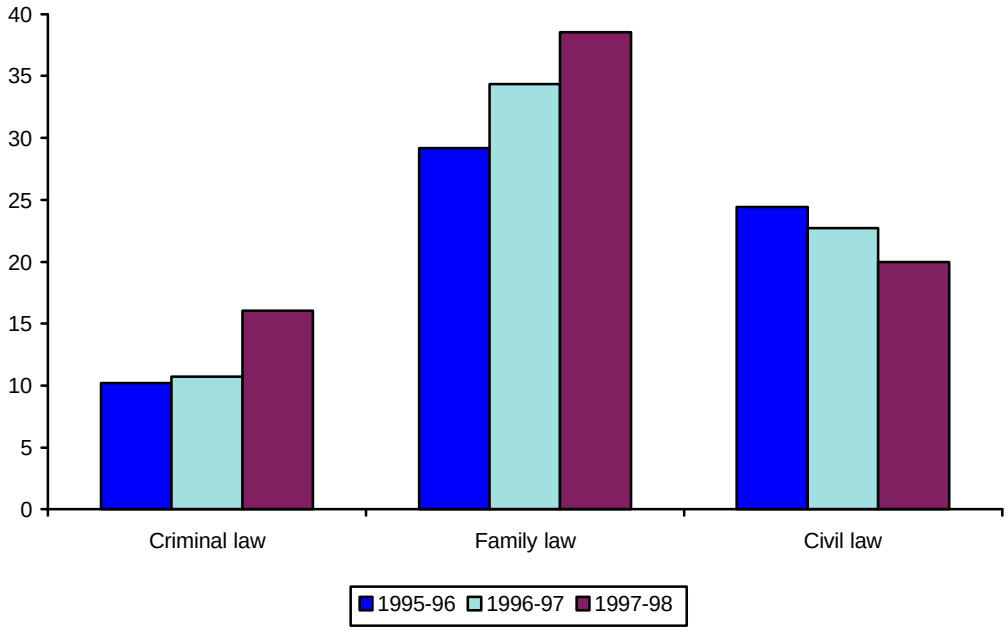
3.4.24 **The above chart further illustrates that the significant reduction in funding available for legal aid in Victoria over the past 3 years has also led to a significant reduction in the community's access to legal aid services. Although VLA had no control over the Commonwealth Government decision to reduce legal aid funding, the impact of the decision was to reduce the community's access to legal aid, which is in direct conflict with one of VLA's primary objectives of providing the community with improved access to justice and legal remedies.**

Rejected legal aid applications

3.4.25 Between the 1995-96 and 1997-98 financial years, the rate of refusal of legal aid applications increased from 17 per cent to 20 per cent. Although of the 3 areas of legal aid provided, criminal law matters had the lowest rejection rate for applications, there was nevertheless a significant increase in the criminal cases refused funding which increased from 10.8 per cent in the 1995-96 financial year to 16 per cent in 1997-98 financial year.

3.4.26 The percentage of family law cases refused funding also increased significantly from 29 per cent to 39 per cent over the same period. In contrast, the refusal rate for civil law cases has progressively decreased over the past 3 years, from 24 per cent in the 1995-96 financial year to 20 per cent in the 1997-98 financial year. These movements are depicted in Chart 3.4D.

CHART 3.4D
LEGAL AID FUNDING APPLICATION REFUSAL RATE BY LAW TYPE
(per cent)



Source: Victoria Legal Aid, Annual Report, 1996-97 and 1997-98.

Appeal of VLA legal aid decisions

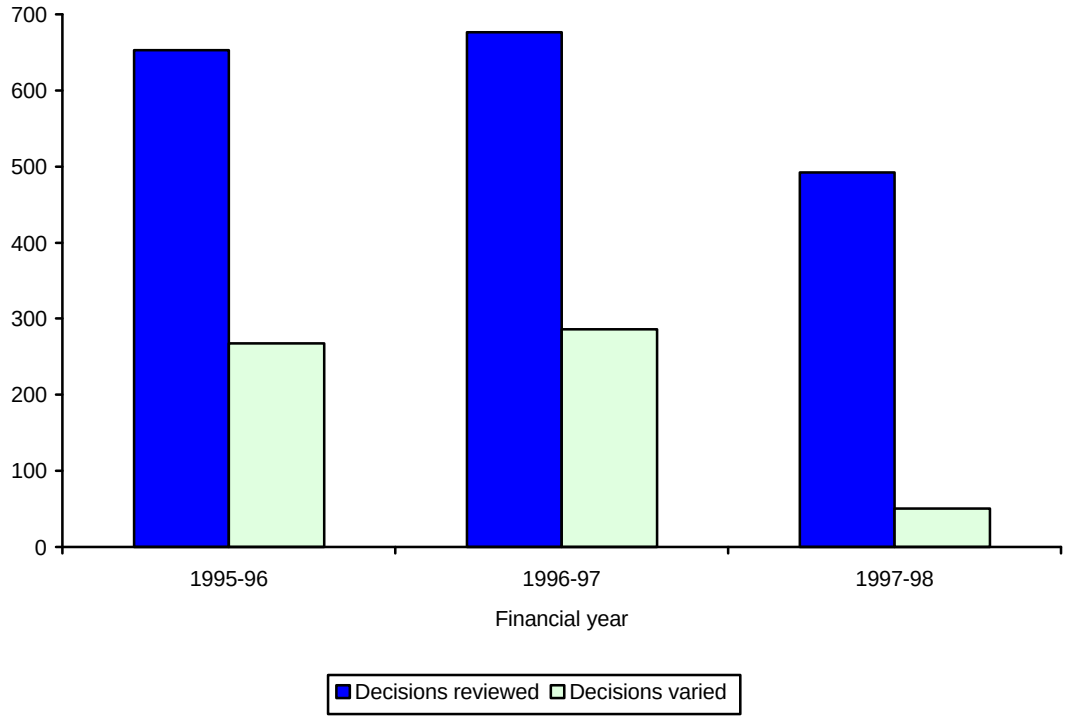
3.4.27 The *Legal Aid Act* 1978 provides that any person who is not satisfied with a decision made in respect of a legal aid funding application can request VLA to reconsider its decision. If the individual is still dissatisfied with the result of the re-assessment, an application can be made for an independent review of the decision. The type of decisions which can be re-assessed or reviewed are defined as those where:

- legal assistance is refused under the *Legal Aid Act* 1978;
- the nature or extent of registered assistance is rejected;
- a condition is imposed on the provision of legal aid assistance under the Act*;* or
- an application for the reimbursement of costs incurred by other parties, under of the Act, are rejected.

3.4.28 Up until 1997, independent reviews of unsuccessful applications for legal aid were performed by Legal Aid Review Committees (LARC), consisting of 5 members of which 2 were not legal practitioners. The Members were nominated to the LARCs by organisations, including the Bar Council of Victoria, the Federation of Community Legal Centres of Victoria, the Law Institute of Victoria, the Victorian Associations of Citizens Advice Bureau and the Collective Self-Help Groups.

3.4.29 In 1997, a panel of 4 independent reviewers was appointed by the Attorney-General to replace the LARCs. Although the function of the independent reviewers is the same as that of the LARCs, each review is undertaken by only one independent reviewer instead a panel of reviewers. VLA considers that the reviewers are more independent and effective than the former LARCs as they are retired judges, solicitors and chartered accountants, rather than practising members of the legal profession. Chart 3.4E illustrates the number of VLA decisions reviewed during previous 3 years and the result of those reviews.

CHART 3.4E
INDEPENDENT REVIEWS OF VLA DECISIONS AND RESULTS OF REVIEWS
(number)



Source: Victoria Legal Aid, Annual Report 1995-96, 1996-97 and 1997-98.

3.4.30 As illustrated in the chart, only 10 per cent of the 492 decisions reviewed during the 1997-98 financial year were varied compared with around 42 per cent of decisions varied during the 1995-96 and 1996-97 financial year. These figures demonstrate the **substantial decrease in the number of decisions varied since the appointment of the independent reviewers and implementation of the new Commonwealth/State Funding Agreement.**

3.4.31 The chart also highlights a significant decrease in the number of independent reviews undertaken during the 1997-98 financial year. This reduction may be attributed to:

- the simplification of the complex guidelines which were inherited from the former Legal Aid Commission of Victoria;
- less people applying for an independent review due to a perception that they were unlikely to be successful; or
- the effective settlement of appeals by VLA's internal review process, which has reduced the need for independent reviews.

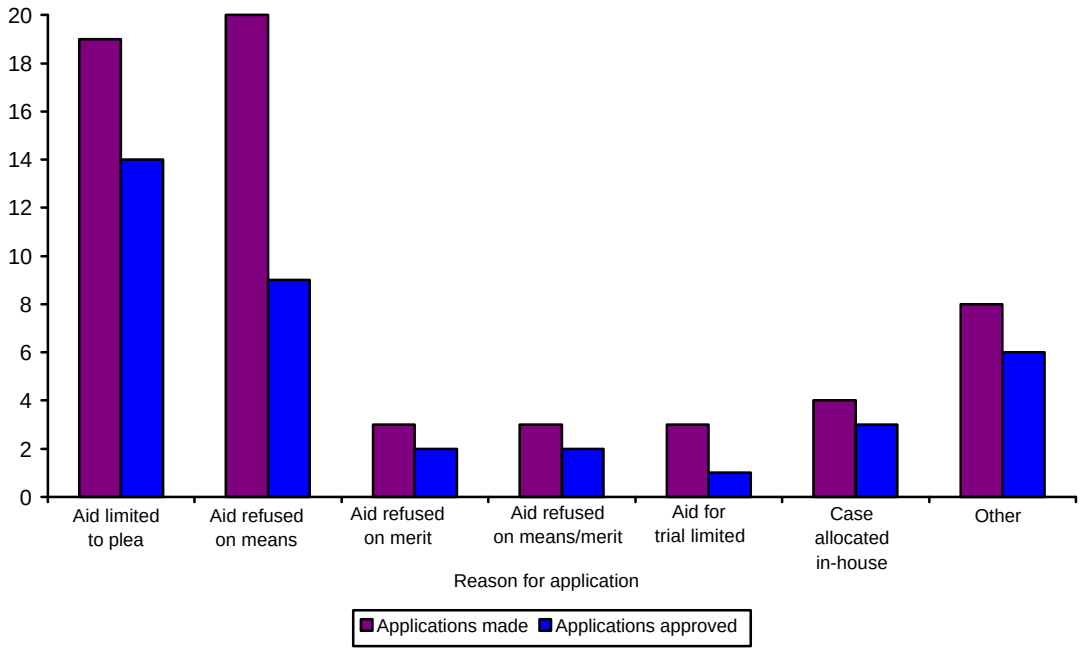
3.4.32 In respect of the internal review of rejected legal aid applications, audit identified that the main reason for the subsequent approval of many of these applications was due to the provision of additional information by the applicant or applicant's private practitioner when appealing the decision.

3.4.33 **Audit considered that the effectiveness of VLA assessments of legal aid applications would be enhanced if more comprehensive information is provided at the time of the initial application. However, audit recognises that this may add to the time consumed by applicants preparing the application and therefore it will be necessary to balance the need and benefit of the additional information against the cost of preparing this information.**

Court applications for provision of legal aid

3.4.34 Victorian courts on occasions exercise their power under the C*rimes Act* 1958 to order the provision of legal assistance for accused persons where, in the opinion of the judge, legal representation is necessary to ensure a fair trial. In this regard, audit identified that around 60 applications were made to courts by individuals under of the *Crimes Act* 1958 since February 1997, the majority resulting from VLA earlier decisions to limit aid to a plea or its refusal to grant aid on the basis the applicant failed to meet the means test. The number of applications made and approved by courts are outlined in Chart 3.4F below.

CHART 3.4F
LEGAL AID APPLICATIONS TO COURTS, FEBRUARY 1997 TO 1999
(number)



3.4.35 VLA assesses each application received against its guidelines. However, with the courts approving 55 per cent of the applications made, it appears that even where an appropriate application of VLA guidelines results in the non-funding of these applicants, in the opinion of the courts, a number of these applicants are unlikely to receive a fair trial without such funding**.**

Commonwealth priorities and guidelines under the new funding arrangements

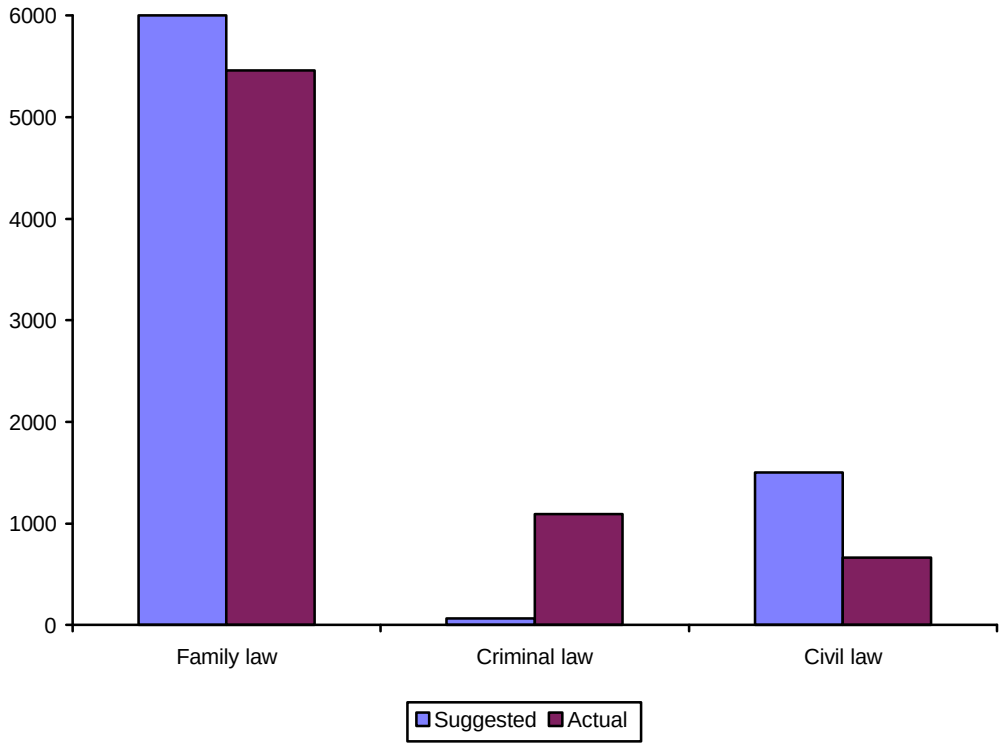
3.4.36 The new funding agreement between VLA and the Commonwealth provides guidance on how funding is to be allocated between family, criminal and civil law matters.

3.4.37 Commonwealth priorities for family law legal aid assistance include matters arising under the Family Law Act, the Child Support (Assessment) Act and the Child Support (Registration and Collection) Act. The Commonwealth has indicated that family law cases should comprise around 79 per cent of all Commonwealth funding legal aid grants in the 1997-98 financial year, making this area the highest priority for legal aid assistance.

3.4.38 Commonwealth priorities for criminal law legal aid assistance include providing representation for individuals charged with a criminal offence under any Commonwealth statute, including charges under the Corporations Law and the State legislation applying to that Act. Legal aid may also be granted where charges are to be dealt with on indictment, or in summary crime matters if the accused faces loss of liberty or livelihood if convicted.

3.4.39 Chart 3.4G compares the suggested number of VLA Commonwealth-funded legal aid grants for each law type as per the 1997-98 Commonwealth/State Funding Agreement, with the actual number of grants made for that year.

CHART 3.4G
COMMONWEALTH-FUNDED GRANTS BY LAW TYPE, 1997-98
(number)



3.4.40 As indicated by the chart, the actual number of grants for Commonwealth criminal law matters was significantly higher than the suggested level, while the actual number of grants for Commonwealth family law and civil law matters fell short of the suggested level.

3.4.41 **This outcome may indicate that the impact of the Commonwealth guidelines on legal aid funding has resulted in different outcomes than those envisaged by the Commonwealth.** As a result, either the guidelines or VLA's application of the guidelines may need to be modified if the desired outcomes of the Commonwealth Government are to be achieved.

3.4.42 In relation to Commonwealth-funded cases, legal assistance would normally be granted where applications meet the guidelines and the means and merits tests. Audit was advised that applications for assistance were not refused on the basis of insufficient funds as the guidelines were "tightened" or "loosened" depending on the availability of funding.

3.4.43 **The revised Commonwealth priorities and guidelines, approved by the Attorney-General in April 1998, contained a paragraph not included in the July 1997 version of the guidelines, which explicitly recognised that fully complying applications may be refused legal aid solely for budgetary reasons. This has formally provided authority for VLA to decline the approval of applications on this basis.**

Application of merits and means tests

3.4.44 As indicated earlier, Commonwealth legal aid funding is provided for cases arising under Commonwealth law which comply with Commonwealth priorities and guidelines. The guidelines require applicants to satisfy a means and merits test. The merits test determines whether assistance will be provided only where in the opinion of VLA staff, based on the particulars of the case, there is a reasonable chance of success. In particular, the Commonwealth merit test takes the following factors into account:

- whether the applicant's case has a reasonable prospect of success;
- whether the ordinary prudent self-funded litigant would risk his/her funds in proceedings; and
- whether it is appropriate to spend limited public funds on the matter.

3.4.45 On the other hand, the merit test applied by VLA to matters arising under State legislation, under the *Legal Aid* Act 1978, only requires VLA to consider the applicants' likelihood of success, which is a less rigorous test than that applied under Commonwealth guidelines.

3.4.46 **The audit review of a sample of legal aid applications revealed that, generally, there was no evidence on client files to support the decisions made regarding the merits test. As a result, audit was unable to determine whether all aspects of the Commonwealth and State merits tests had been appropriately applied.**

3.4.47 **Audit acknowledges that a large number of applications are of a low dollar value and that fully supporting the reasons for compliance with the merits test in all cases may be overly onerous. However, audit recommends that, as a minimum, the assessment of the means and merits tests on applications over a predetermined value should be adequately documented.**

Legal aid limits

3.4.48 Both Commonwealth and State guidelines place ceilings on the value of legal aid assistance to be provided in relation to criminal and family law cases in order to ensure the available funding is distributed as widely as possible.

3.4.49 In the Auditor-General's previous audit of the former Legal Aid Commission of Victoria, which was reported to the Parliament in the November 1993, it was identified that in the period July 1987 to January 1993, around 40 per cent of the Commission's budget was spent on cases exceeding $5 000 which indicated that a significant portion of the former Commission's resources were spent on a small number of higher cost cases.

3.4.50 Table 3.4H sets out the fee ceilings set for both State and Commonwealth-funded legal aid.

TABLE 3.4H
COMMONWEALTH AND STATE FEE CEILINGS

Type of matter	*Commonwealth ceiling*	*State ceiling*
Adult in Family Court	$10 000	Not applicable
Child representative in Family Court	$15 000	Not applicable
Criminal trials in Supreme Court	$40 000 (plus $20 000 for each co-accused, prior to 1 July 1998)	$30 000 for cases other than conspiracy. $60 000 for conspiracy cases.
Criminal trials in County Court	$40 000 (plus $20 000 for each co-accused, prior to 1 July 1998)	$15 000 for cases other than conspiracy. $30 000 for conspiracy cases.

3.4.51 Commonwealth fee ceilings were determined following consultation with the States and Territories. As indicated in the above table, the Commonwealth-funded cases provide a higher fee ceiling for criminal law matters than State-funded cases.

3.4.52 Audit also noted that the State fee ceilings for criminal law matters are significantly lower than those set by other legal aid commissions, such as those in South Australia and NSW, where funding of up to $50 000 and $80 000 is provided, respectively, for one defendant.

3.4.53 It is acknowledged that there are likely to be differences in the composition of legal aid cases funded throughout Australia. For example, the average duration of trials under Commonwealth criminal law are generally longer than those under State criminal law and, as a result, may be more expensive. **However, given the large differences in the fee ceilings among different jurisdictions, individuals charged under Victorian law and qualifying for legal aid may be receiving less assistance than someone charged under State criminal law in another jurisdiction or under Commonwealth criminal law.**

3.4.54 An audit review of the application of cost ceilings for criminal law matters approved from July 1997 to January 1999 disclosed 9 cases where the fee ceiling had been extended. In the Supreme Court, 3 further cases were identified where the fee ceiling of $30 000 for State criminal law matters had been exceeded. In a number of these cases, court delays caused the trial to be extended beyond the original grant of aid, however, the court provided an Appeals Cost Certificate resulting in the Appeals Cost Board of the Department of Justice reimbursing VLA for solicitor's costs incurred during the delays.

3.4.55 It was also identified by audit that there were 11 family law cases approved during the period from July 1997 to January 1999, where the fee ceiling had been reached, or was close to being reached, and 3 family law cases where certified costs were up to $700 in excess of the fee ceiling. In the majority of instances where the fee ceiling had been reached, the cases had been finalised and the private practitioners had agreed to forgo costs incurred above the fee ceiling. In the 3 instances where certified costs were in excess of the fee ceiling, audit could not find any documentation on VLA files supporting the decision to increase the fee ceiling. Discussions with VLA indicated that these overpayments resulted from administrative errors and that the fee ceilings should not have been exceeded in these cases.

3.4.56 **Internal controls over the certification of fees for family law cases could be improved by requiring:**

- **any payments above fee ceilings to be adequately supported and documented; and**
- **independent senior VLA officer approval, prior to allowing certified costs to exceed the fee.**

Identification of need for legal assistance

3.4.57 In order to provide effective legal aid services in Victoria, it is necessary to determine and understand the need for these services within the community. However, to date no comprehensive review of community need for legal aid services has been completed.

3.4.58 The absence of information on legal aid need in the community was identified in a submission by the Federation of Community Legal Centres to the Commonwealth Senate Legal and Constitutional References Committee Inquiry into the Australian Legal Aid System in 1997, which indicated that there is a lack of information regarding the actual level of need in the community for legal aid and, therefore it is impossible to determine the effect of reductions in legal aid funding and tighter guidelines. This was confirmed by the Victorian Bar Council submission to the Inquiry which indicated that there was an absence of data on the number of unrepresented litigants in Victoria, and on the number receiving inadequate representation because of a shortfall in legal aid funding.

3.4.59 The Federation of Community Legal Centres further contended that information regarding the number of applications and approvals does not provide an indication of community need for legal aid as an increasing number of agencies and private practitioners are not making applications for legal aid as:

- they know that the tightened guidelines will result in legal aid being refused;
- it is time consuming to make application; and
- the amount of aid, if provided, will be insufficient to enable the required legal work to be performed.

3.4.60 In 1995, the Commonwealth Government initiated a legal aid "Needs Survey", however, the intention of this survey was to determine an appropriate basis for the distribution of legal aid funding in the 1997-98 financial year, rather than to determine the unmet need for legal aid in the community. At the date of preparing this Report, this review had still not been completed by the Commonwealth Government.

3.4.61 **In audit opinion, in the absence of the finalisation of the Commonwealth study, VLA should undertake an assessment of need for legal aid within the Victorian community to assist it in allocating scarce legal aid funding in the most effective and equitable manner, and to determine the impact of changes to legal aid guidelines on the provision of legal aid services in Victoria.**

3.4.62 **It is also recommended that VLA, in consultation with the courts, collect and maintain other relevant information to assist it in its application of legal aid funding, such as:**

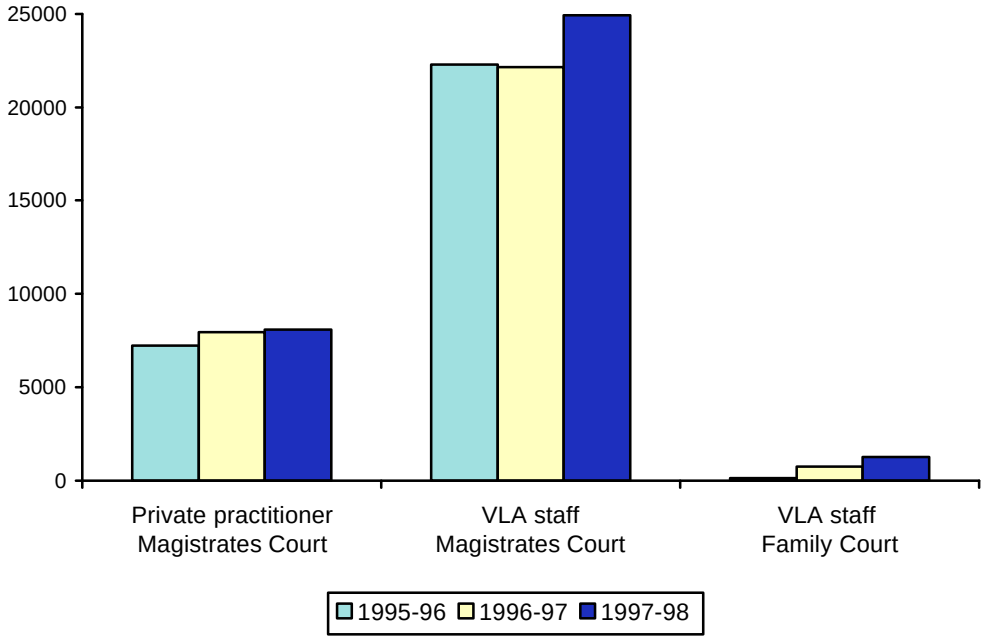
- **individuals who are unrepresented in court;**
- **types of pleas in criminal courts; and**
- **use of "pro bono" schemes.**

Use of duty lawyers

3.4.63 Duty lawyers attend courts and advise and appear for persons attending courts without legal representation. Duty lawyer services are provided by both VLA staff and private practitioners in the Children's Courts and Magistrates Courts. A duty lawyer service is also provided by VLA staff at the Melbourne Family Court. In addition, VLA solicitors participate in a scheme run by the legal profession at the Dandenong Family Court. When requested, VLA staff also provide duty lawyer assistance at the County Court.

3.4.64 As illustrated in Chart 3.4I, demand for duty lawyer services has increased since the 1995-96 financial year, particularly in the Magistrates and Family Courts. In the Family Court, advice provided by duty lawyers increased 30 fold and the number of hearings attended increased 10 fold during the period from the 1995-96 financial year to the 1997-98 financial year. In the Magistrates Court, during the same period, attendances by duty lawyers at mentions and pleas increased by 46 per cent and 31.5 per cent, respectively, over this period, indicating a greater demand for legal representation since the introduction of the stricter guidelines for criminal law matters.

CHART 3.4I
DUTY LAWYER SERVICES PROVIDED, 1995-96 TO 1997-98
(number)



Source: Victoria Legal Aid, Annual Reports, 1997-98 and 1996-97.

3.4.65 Although duty lawyers are experienced in Magistrates and Family Court practice, they are unlikely to be a substitute for a well briefed and prepared legal representative. As a result, it could be argued that individuals using these services may receive a standard of legal representation which is inadequate for their needs and which is likely to adversely impact on the outcome of their cases.

3.4.66 **The increased use of duty lawyers is likely to be a direct consequence of reductions in the overall level of VLA funding for legal aid in Victoria.**

Additional funding following completion of audit review

3.4.67 **Following the completion of the audit review, the Attorney-General on 30 April 1999 announced that an additional $4 million of funding will be provided for legal aid in the 1999-2000 State budget which will improve VLA's capacity to provide assistance to the community.**

❒ ***RESPONSE*** *provided by Managing Director, Legal Aid Victoria*

Impact of initiatives on VLA's operations

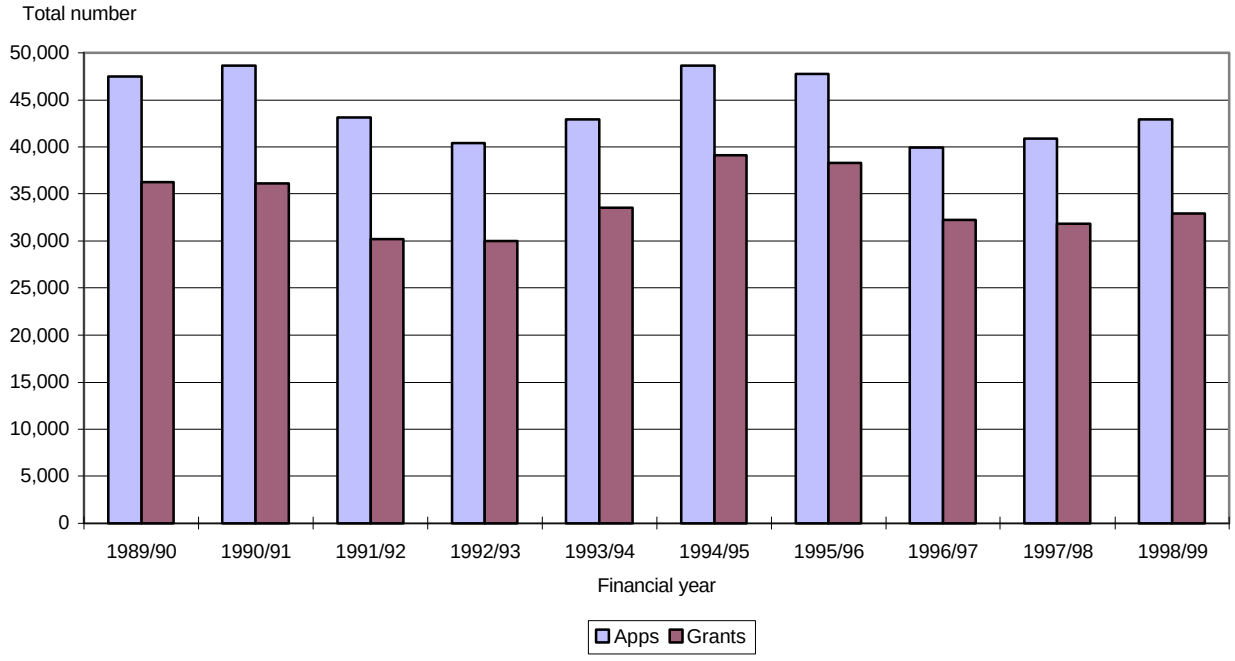
It is inappropriate to compare service levels using 1995-96 figures as a definitive starting point. The Legal Aid Commission of Victoria operated at significant cash deficit that year ($6.4 million), following the adoption of a policy to make extra grants and run down reserves. The number of grants made that year exceeded the financial capacity of the organisation to meet their cost from current revenue.

While the VLA initiatives referred to would have had a significant impact on applications and approvals, other factors would have had an influence as well. Applications would have been refused for a number of reasons not necessarily directly related to funding issues:

- *The applicant did not meet the stringent national legal aid means test applied by all legal aid commissions;*
- *The type of matter did not fall within VLA's or the Commonwealth's guidelines for assistance;*
- *The case the applicant wished to conduct did not meet the legal merit test; and*
- *In Commonwealth cases, the case was not one which an ordinarily prudent self funding litigant would pursue.*

Applicants and approvals vary over a period of time as can be seen from this Chart which covers the 10 year period 1989-90 to 1998-99:

TOTAL APPLICATIONS RECEIVED AND APPROVED



(a) From 1 July 1997, figures include child support and war veteran's cases.

(b) The 1998-99 figures used in this and all of the other VLA charts are estimated for the full year.

❒ ***RESPONSE*** *provided by Managing Director, Legal Aid Victoria - continued*

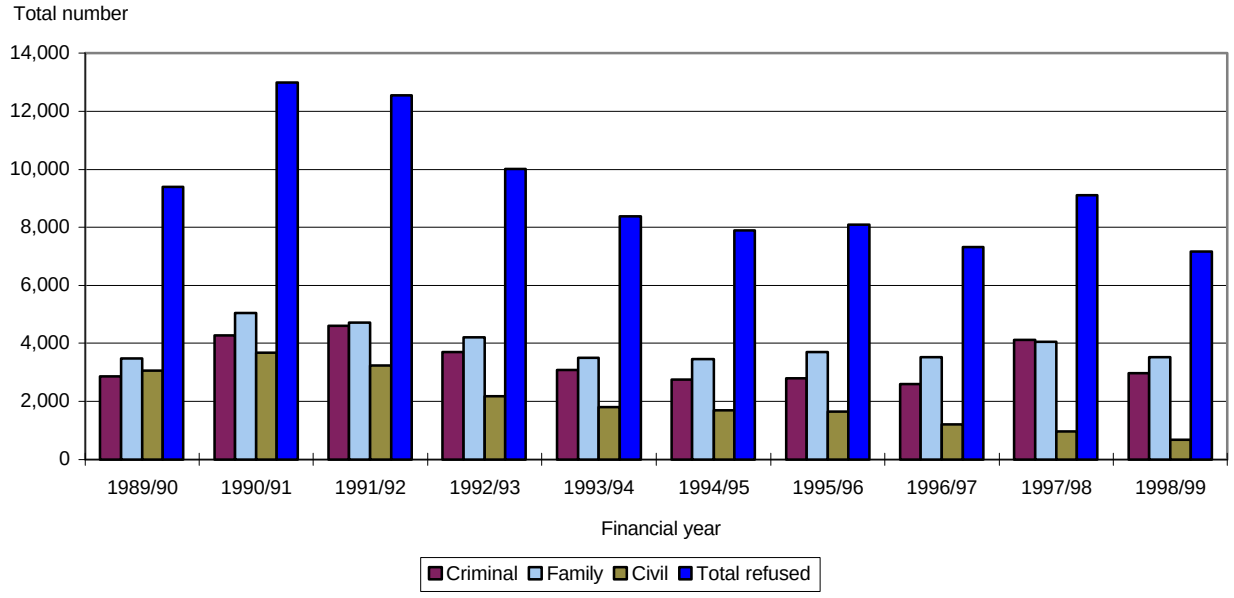
These statistics indicate:

- *Applications received and grants made over the last 3 years are well within the range established by the organisation over the last 10 years;*
- *VLA's business has operated in 3 or 4 yearly rather than annual cycles. This is most likely explained by the fact that, on average, a grant of assistance results in bills for payment over a 2 to 3 year period (or longer), not just the year in which the grant is made;*
- *Victoria Legal Aid's business established a new level in 1996-97 and then commenced to grow again in 1997-98. That growth has continued in 1998-99. Recent changes to ease guidelines will result in more growth in grants in 1999-2000; and*
- *If it is accurate to say that applications and grants were reduced by the tightening of guidelines in 1996, then they will be increased by the Board's easing of guidelines in September 1998 (when Victoria Legal Aid announced that it would make a further 3,000 grants a year in summary criminal matters, increase fees to private practitioners carrying out legal aid work and a number of other initiatives).*

Rejected legal aid applications

This Chart shows that refusals of applications (by law type) over the last 3 years are well within the range established by the organisation over the last 10 years:

TOTAL NUMBER OF REFUSALS



❒ ***RESPONSE*** *provided by Managing Director, Legal Aid Victoria - continued*

Appeal of VLA legal aid decisions

Victoria Legal Aid has simplified many of the guidelines it inherited from the Legal Aid Commission of Victoria. That simplification has reduced the scope for disagreement about VLA's initial decision.

One example is the guideline relating to summary criminal cases. The LACV classified summary criminal cases into 3 levels (A1, A2 and A3) with different fee levels attaching to each. The level of classification of a matter gave rights to internal reconsideration and review by a Legal Aid Review Committee.

Victoria Legal Aid set a standard fee ($409) for all summary criminal cases. This one decision removed all requests for reconsideration and review of summary criminal categorisation from the review system. Given that VLA makes around 20,000 summary criminal grants a year, the simplification of this fee arrangement is likely to be a very significant factor in the reduction in matters going to independent review. Other guideline changes would have contributed to that result as well.

The Report assets that a reason for the reduction in reviews may be that "less people are applying for an independent review due to a perception that they were unlikely to be successful". No evidence is offered for this assertion.

Court applications for provision of legal aid

The following factors need to be taken into account:

- *On many occasions VLA refused assistance on the basis of means rather than the merit of the applicant's case. However, the courts have taken a more liberal view of applicant's means in individual cases than VLA did in applying the national legal aid means test; and*
- *Victorian judges made orders for assistance in cases which would not have resulted in a stay of proceedings under the Dietrich principle. For example, one Victorian judge ordered Victoria Legal Aid to provide 2 barristers instead of the one experienced criminal barrister VLA had already agreed to provide for the defendant. In another case, a judge ordered Victoria Legal Aid to pay for an expert's report. In neither of these cases would a court in any other Australian jurisdiction have found that the trial should be stayed because the defendant could not receive a fair trial.*

Parliament amended section 360A significantly in 1998 to limit the extent to which the courts were using their power to order legal assistance under that section.

Commonwealth priorities and guidelines under the new funding arrangements

The original numbers of cases contracted to be conducted under the new Commonwealth agreement which commenced on 1 July 1997 were broad estimates based on past history (established under different guidelines and funding arrangements). The Commonwealth and all Australian legal aid commissioners are applying considerable effort to establishing better and more accurate grants and cost measures for future agreements.

❒ ***RESPONSE*** *provided by Managing Director, Legal Aid Victoria - continued*

Legal aid limits

Victoria Legal Aid rejects your conclusion that Victorians "may be receiving less assistance than someone charged under a State criminal law in another jurisdiction or under Commonwealth criminal law."

The following points are relevant to any consideration of to fee ceilings:

- *Commonwealth criminal cases take on average much longer than State cases and therefore cost considerably more;*
- *The full Victoria Legal Aid fee ceiling applies for each defendant in a criminal case. However, prior to 1 July 1998, the Commonwealth halved the amount of the fee ceiling for additional defendants. Accordingly, for a trial of 2 defendants in the Supreme Court, the fee ceiling for both commonwealth and State matters aggregated the same figure, although the Commonwealth prosecution was likely to be much longer. If there were 3 defendants, the VLA fee ceilings would have been higher in aggregate.*
- *Comparisons with costs in other states are only relevant if the average cost of legal services in those states can be factored into the comparison. In any event, a more detailed analysis of the activity and operation of other legal aid commissions than has been undertaken in this Report would be needed before any valid conclusions could be drawn about costs in those jurisdictions.*

Your conclusion that individuals charged under Victorian law "may be receiving less assistance than someone charged ... in another jurisdiction" ignores:

- *The discretion vested in the Managing Director and General Manager, Grants to exceed the fee limits in appropriate criminal cases. Paragraph 5.2 of VLA's Legal Aid Handbook states that, in expensive indictable criminal matters, "... the Managing Director and General Manager, Grants will determine the amount that VLA will pay in excess of the costs ceiling".*
- *The power of Victorian courts to order VLA to provide assistance under section 360A of the Crimes Act. No other state has given its courts a statutory power to order its legal aid commission to provide legal assistance to a defendant facing serious criminal charges;*
- *Given limits on legal aid funding, controlling the amount spent on one legally assisted client means that more clients can be aided; and*
- *The quality and effectiveness of legal assistance is not measured by the amount spent on lawyers.*

Identification of need for legal assistance

The Commonwealth Government's legal aid needs study is intended to determine "the unmet need for legal aid in the community". That study is about to be completed.

It is VLA's view that this issue should be deferred until the commonwealth needs study has been published and the experience gained and lessons learnt from that expensive inquiry can be fully gauged and assessed by VLA.

❒ ***RESPONSE*** *provided by Managing Director, Legal Aid Victoria - continued*

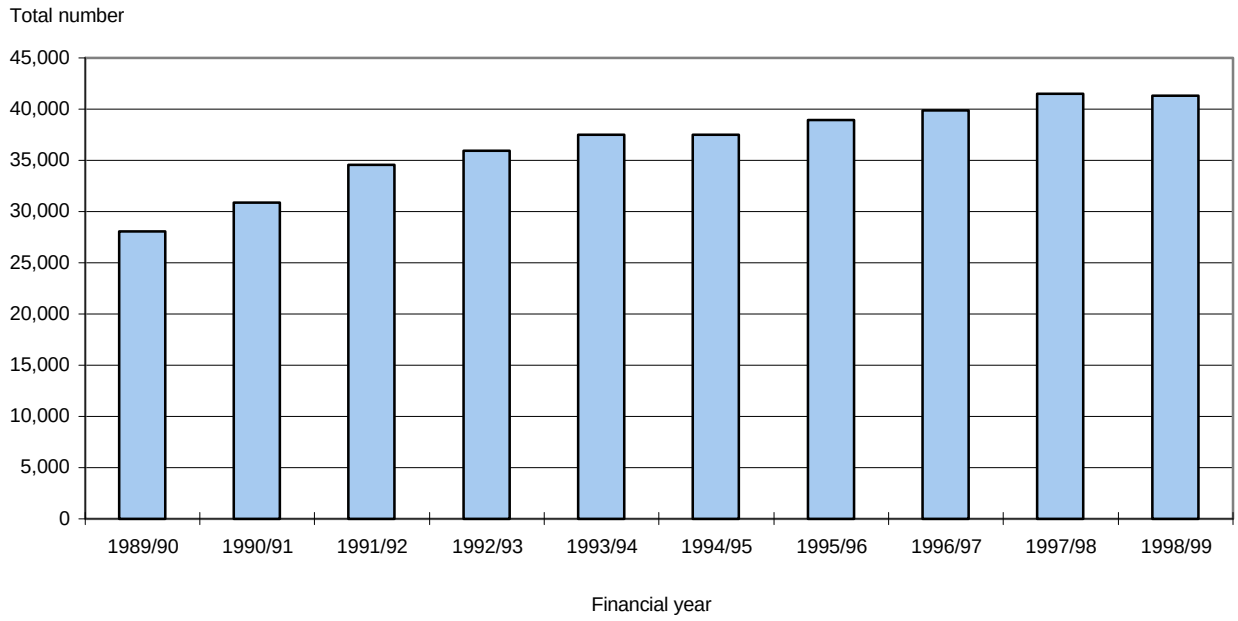
The Report recommends VLA maintains certain records to assist it in its application of legal funding. VLA notes:

- *As far as VLA is aware, no record is kept of unrepresented litigants in court;*
- *Individuals who are unrepresented may not want legal assistance or, in any event, may not qualify for legal assistance under the means or merits test (or both). Accordingly, information about unrepresented litigants alone does not indicate levels of unmet need for legal assistance; and*
- *Information about the use of formal pro bono schemes which maintain and publish records seems to VLA to be of very limited assistance. For example, the Lawaid Scheme commenced operation on 26 March 1997 but has made only 35 grants of aid in 21 months' operation to 31 December 1998.*

Use of duty lawyers

The use of duty lawyer has grown steadily since 1989-90 as this graph illustrates:

DUTY LAWYER SERVICES



That growth would have been affected by a number of factors in addition to changes in guidelines or funding levels over that period. Those factors could include the financial situation of people charged with offences, the cost of a private lawyer, any increase in the total number of people charged, the volume of business processed by the courts and changes to court procedures (for example, the introduction of mention hearings).

This 10 year overview does not indicate any sudden or undue growth in duty lawyer services over the last 3 years.

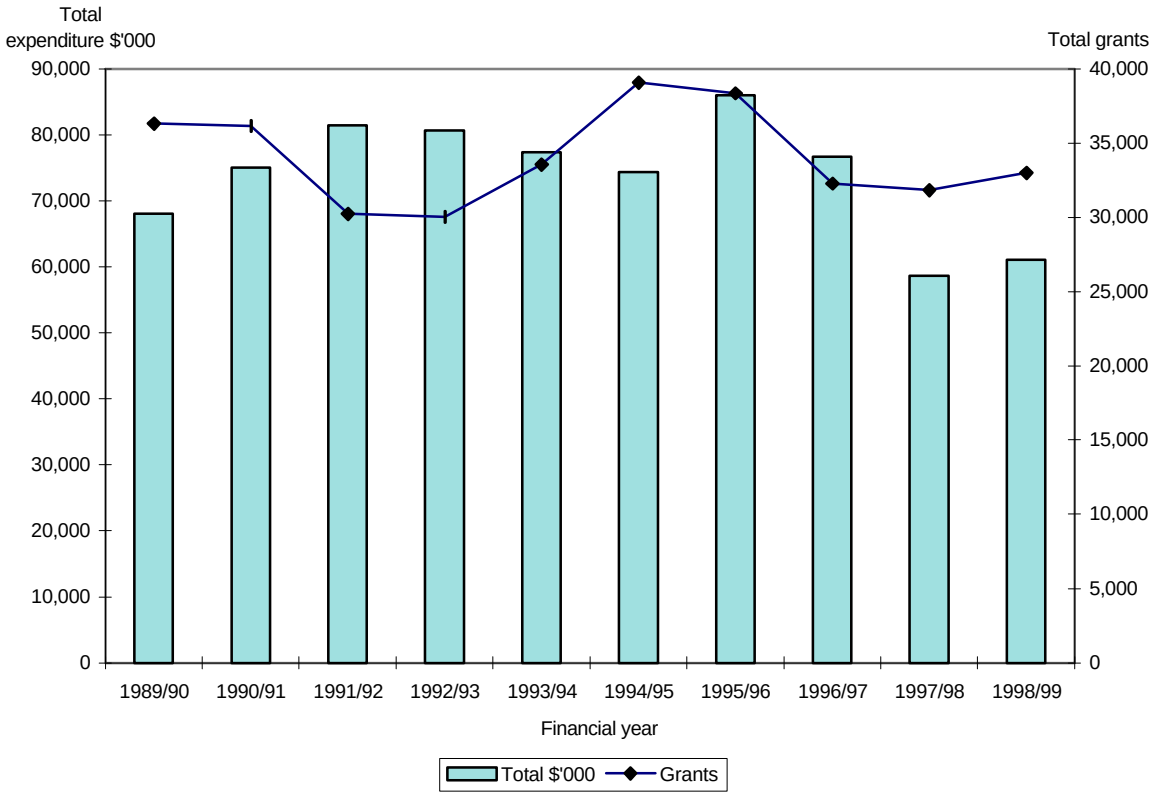
❒ ***RESPONSE*** *provided by Managing Director, Legal Aid Victoria - continued*

General

The charts set out in these responses indicate that VLA is operating well within the range of activity established by this organisation and its predecessor Legal Aid Commission of Victoria over the last 10 years.

That level of activity has been maintained at the same time as VLA has achieved a huge reduction in operating costs. Operating expenses (before abnormal items) fell from $86 million in 1995-96 to $58.68 million in 1997-98 - a drop of 32 per cent. The relationship between total expenditure and the number of grants over the last 10 years can be seen from this graph:

TOTAL EXPENDITURE AND GRANTS



The Auditor-General's 1993 performance audit of the former LACV noted the public no longer had the same access to legal services due to the continuing increase in their cost. The figures set out above indicate VLA has made significant progress in addressing this concern in legal aid cases.

❒ ***RESPONSE*** *provided by Managing Director, Legal Aid Victoria - continued*

VLA has increased service levels to Victorians this year and expects to do so again in 1999-2000.

VLA has been at the forefront of improving efficiency and effectiveness in the delivery of legal aid services. It has demonstrated that it is possible to maintain tight control over costs in legal aid grants, particularly by limiting the maximum fee for an individual grant of assistance. While this approach may have been considered severe in its initial stages, there are signs that it is leading not only to improvement in the way legal aid grants are managed, but also to better planning by lawyers of how they use the funds provided under a grant, and tighter control by the courts of the trial process to ensure that matters are dealt with within the resources available through a legal aid grant.

URGENT NEED FOR ENHANCED PUBLIC ACCOUNTABILITY COVERING NON-JUDICIAL FUNCTIONS OF VICTORIAN COURTS

Outline of principal issue

3.4.68 In June 1996, I reluctantly determined not to transmit a performance audit Report to the Parliament on the Children's Court. My decision followed consideration of a second legal opinion by the Solicitor-General provided to me by the Department of Justice on the evening prior to the intended tabling of the Report. That opinion explicitly stated that, as the scope of the audit was beyond the jurisdiction of the Auditor-General under the *Audit Act* 1994, there was no authority to table the Report in Parliament.

3.4.69 The core basis of the Solicitor-General's opinion was that a Court exercising judicial power and performing judicial functions is not a "department" or "public body" and therefore not an "authority" within the meaning of section 16(1) of the Audit Act. This section deals with the performance audit function of the Auditor-General.

3.4.70 The Solicitor-General stated *"... the Auditor-General had no jurisdiction to undertake an audit in relation to the functioning of that Court* [the Children's Court], *and therefore no power to report upon such an audit. Likewise I do not consider that the Auditor-General has jurisdiction to undertake an audit in relation to the functioning of any other Court constituted under Victorian law"*.

The ability of the Auditor-General to examine non-judicial elements of the operations of Victorian courts remains an issue of contention.

3.4.71 The Solicitor-General emphasised the conclusions reached concerning the construction of section 16 and the scope of the jurisdiction of the Auditor-General were in accordance with the principle of non-interference by the legislative and executive arms of government with the functioning of the judicial arm. This principle derives from the doctrine of separation of powers.

3.4.72 At the time of my decision not to table my performance audit Report, the Attorney-General and I agreed, following discussions, that there was a need for urgent resolution of the issues raised in the legal advice in terms of what elements of operations relating to any Victorian court could be legitimately examined by the Auditor-General on behalf of Parliament, without impinging on the fundamental principle of judicial independence. It was envisaged that consultation with the judiciary via the Council of Judges would be a necessary course of action.

3.4.73 The importance of clarifying the boundaries of an Auditor-General's powers in this area was reinforced by the fact that 2 legal opinions obtained by the Department of Justice from the Solicitor-General and the Victorian Government Solicitor just a month earlier in May 1996 clearly indicated the non-judicial or administrative functions undertaken by officers of the Department on behalf of courts were within the scope of the Auditor-General's performance audit powers under section 16.

3.4.74 The relevant comments within the 2 opinions were as follows:

Solicitor-General's opinion of 16 May 1996

"*It must, of course, be recognised that the Children's Court is supported by administrative services which are provided by the Department of Justice. Accordingly, many officers of that Department will, to a greater or less extent, be concerned in the administrative functioning of the Children's Court, the administration of financial matters relating to it and the provision of staff, equipment, premises and other services which enable the Children's Court to operate. Therefore, although the Children's Court is constituted as a separate and independent judicial entity in this State, the administrative activities of those officers are within the scope of the jurisdiction of the Auditor-General under s.16 of the Audit Act 1994*".

Victorian Government Solicitor's opinion of 16 May 1996

"*... the power of the Auditor-General conferred by s.16(1) extends to auditing the actions of officers involved in the work of the Children's Court, such as those officers of the Department of Justice and of the former Health & Community Services. The audit can be to determine whether they are achieving their objectives effectively and doing so economically, and complying with relevant Acts such as the Children and Young Persons Act. The power does not extend into the functions of magistrates*".

3.4.75 In expressing the above views, both opinions drew attention to the difficulty at times of distinguishing between the activities of the relevant Department on the one hand and of the Children's Court on the other. Also, on this point, the Secretary of the Department recently conveyed the following view to audit:

> "*I need to emphasise that although the distinction may be clearly stated, in practice, sometimes it is difficult to distinguish between, on the one hand, the actions of administrative officers and on the other hand the administrative actions of judicial officers and those who immediately report to the judicial officers in providing administrative support to the exercise of judicial functions. For example, it would be appropriate to audit the activities of departmental officers in respect of the installation of and maintenance of IT support for courts but it would not be appropriate to audit the actions of judicial and non-judicial officers in respect of the use of IT technology to erect and maintain a case-flow management system for the operation of the court.*"

Response by the Government to the matter

3.4.76 In January 1997, I wrote to the Attorney-General seeking advice on the nature of action taken by the Government to resolve the position involving audits of courts by the Auditor-General.

3.4.77 I did not receive a reply from the Attorney-General but, in April 1997, the Department of Justice forwarded to me a copy of *Guidelines for Audits in the Supreme Court, County Court and the Magistrates' Court* which it advised had been developed in conjunction with court officials. I was asked to bring these guidelines to the attention of my staff.

3.4.78 My Office had not been accorded an opportunity to consult with the Department or the judiciary on the content of the guidelines. In July 1997, I conveyed to the then Secretary of the Department some suggested changes to the guidelines and the wish that some discussions could take place. The departmental response to me reinforced in very direct terms the view that, given the June 1996 legal advice, there was no longer a performance audit role for the Auditor-General in respect of **both** judicial and non-judicial functions within courts.

Serious public accountability implications from direction of developments

3.4.79 The guidelines issued by the Department preclude any performance audit involvement by my Office in examining any aspect of the managerial functioning of judicial bodies within the State where the results of the audit would be reported to the Parliament and, in turn, to the community. The Department regards the June 1996 legal opinion by the Solicitor-General as all embracing in terms of coverage of the activities of courts and as overriding the 2 earlier legal opinions which specifically stated that the Auditor-General was authorised to examine and report on the management of non-judicial functions. The Department has indicated its stance on this matter must be always in line with the June 1996 legal opinion.

3.4.80 The guidelines do recognise my legislative authority under the Audit Act and the Financial Management Act for undertaking the audit of the Department's annual financial statements but specify that the scope of this audit in relation to courts is confined to the administrative and financial systems relevant to public moneys and public assets. In other words, my annual financial audit must solely focus on the verification of financial transactions and assets relating to courts and cannot be extended to assess the efficiency of use of public resources within courts.

3.4.81 In addition, the guidelines provide for the involvement of the Department's internal auditor or a private sector auditor appointed by the Department in the examination of management issues associated with non-judicial functions of courts, under a process overseen by the Department after consultation with the relevant court and, if necessary, consideration of legal advice. The results of any audit conducted under this internal accountability framework are reported to the Department and the court.

3.4.82 It should be said that the guidelines also enable the Auditor-General to participate in the internal audit process but subject to certain specified conditions of operating under the oversight of the Department and reporting only internally to the Department and the respective court. I have informed the Department that these latter conditions are not acceptable as the Auditor-General is directly accountable to the Parliament for the reporting of audit results. In addition, it would be highly inappropriate for the Department to oversee any audit conducted by the Auditor-General, given it would be a principal subject of the audit because of its responsibility for the management of public resources associated with the administrative functioning of courts.

Curtailment of scope of several audits since June 1996

3.4.83 Because of the legal position presented to the Department on behalf of the Government on this important public accountability issue, I have been forced to curtail the scope of several audits over the period since June 1996. These audits were planned to cover non-judicial or administrative functions within certain judicial bodies in Victoria and, in my opinion, because of their focus on management procedures would not have impinged on the fundamental principle of judicial independence. Relevant details of these audits are set out below:

1. ***An examination of Supreme Court investment practices, June 1996***

   This audit had been requested by the Chief Justice of the Supreme Court around the time of the Children's Court audit and did not proceed in the light of the Solicitor-General's June 1996 opinion.

2. ***An assessment of the timeliness of service delivery in certain administrative functions by the former Administrative Appeals Tribunal (now the Victorian Civil and Administrative Tribunal), October 1996***

   In October 1996, I reported in my Special Report No. 44 to the Parliament on the results of my performance audit of the timeliness of service delivery in a number of public sector agencies. The scope of this audit activity included an examination of the timeliness of administrative functions within the former Administrative Appeals Tribunal such as the extent of time between the lodgement and hearing of appeals. However, as I indicated to the Parliament in that Report, I was unable to disclose the results of this particular aspect of the performance audit because of the restrictions arising from the Solicitor-General's opinion on the Children's Court audit and the absence of any resolution to the resultant impasse.

3. ***An evaluation of the management of infant investment trust accounts by the State's judicial bodies, May 1998***

   This evaluation was conducted under the authority of section 15 of the Audit Act as an extension of the annual audit of the financial statements of the Department. It focused on the management of around $318 million (as at 30 June 1997) by the State's major judicial bodies which was held in trust on behalf of persons under the age of 18 years, or those who have a legal disability.

   At the conclusion of this audit, discussions were held by my Office and the Department with the Solicitor-General on the matters addressed in the draft report. As a result of views expressed by the Solicitor-General, I was obliged to delete from my Report to Parliament key comments relating to the management of these trust moneys. The relevant views of the Solicitor-General provided in written advice to my Office were as follows:

   > "*It is accepted that it is appropriate for a financial audit to be undertaken in relation to the funds held on behalf of infants by the Supreme Court, the County Court, the Magistrate's Court and the Victims of Crime Agency. However, it is also accepted that it is not appropriate for a performance audit to be undertaken in relation to the administration of such funds. Whilst it is not always easy to draw a distinction between the two categories of audit, it seemed to me that, in the context of funds in court held on behalf of infants, it was appropriate that the audit should extend to the systems and procedures relevant to the receipt and payment of funds and to the provision of trust fund information to beneficiaries. On the other hand, it appeared to be inappropriate for the audit to extend to the systems and procedures relevant to the management and investment of funds held in trust for infants, or to the management of such funds to ensure that the funds are both secure and generate a reasonable return.*"

   The Solicitor-General went on to indicate that the sections of the draft report dealing with "*... comparative rates of returns and putting forward recommendations for legislative change were not in accordance with my understanding of the scope of a report upon a financial audit*". He stated it would be quite appropriate for the Auditor-General to bring these matters to the attention of the Secretary of the Department of Justice.

4. A performance audit of the State's planning system, July 1998

This performance audit is currently underway. During preliminary planning for the audit, my Office identified that the Victorian Civil and Administrative Tribunal formed an integral part of the planning system. Accordingly, I wrote to the Secretary of the Department in July 1998 seeking discussions on issues relating to access by my Office to the Tribunal and the reporting of information gathered during this process.

Discussions did take place, however, the Secretary formally advised me in September 1998 that the Solicitor-General's legal advice of 19 June 1996 applies with equal force to the Victorian Civil and Administrative Tribunal. I was informed that as such there was no statutory authority for the inclusion of that Tribunal in the proposed performance audit of the State's planning system.

3.4.84 In addition to the above audits, my Office has recently finalised the planning of a performance audit dealing with the operations of State Trustees. Following consultation with the Parliament's Public Accounts and Estimates Committee and executive management of State Trustees, I have determined to include within the performance audit specification provision for evaluation of the activities of certain bodies including the Victorian Civil and Administrative Tribunal and the Senior Master of the Supreme Court relating to their roles with respect to represented persons. I am fearful, however, that the circumstances I have outlined above in terms of my capacity to undertake an audit of management procedures within courts may well preclude me from either examining or reporting to the Parliament on matters relating to this area of the audit plan.

3.4.85 I consider that the developments that have transpired in this matter are totally unsatisfactory in terms of the serious public accountability implications to the Parliament and the community.

3.4.86 Since 1996, based on the Solicitor-General's legal advice, issues associated with the efficiency of management of public funds in administrative or non-judicial activities within judicial bodies in Victoria have effectively been quarantined from my scrutiny carried out on behalf of the Parliament and taxpayers. An indication of the magnitude of these funds can be gleaned from the fact that expenditure directly controlled by the Department covering the operations of the State's judicial bodies totalled around $179 million or 39 per cent of total departmental controlled expenditure in 1997-98 and related controlled assets amounted to over $160 million or 37 per cent of total departmental controlled assets in that year.

3.4.87 As a consequence, there has been no information channelled to the Parliament from the Auditor-General since 1996 on the performance of the Department of Justice and judicial bodies in discharging their significant responsibilities for the efficient management of public resources in this area.

The position elsewhere in Australia and New Zealand

3.4.88 Research carried out by my Office concerning the position on the audit of non-judicial functions of courts in other jurisdictions indicates the Victorian situation is very much the exception rather than the rule. No other Auditor-General has experienced the circumstances prevailing in Victoria.

3.4.89 In the Northern Territory and New Zealand, the non-judicial functions of courts are undertaken by a specially designated government agency, the Office of Courts Administration and the Department for Courts, respectively. In most other jurisdictions, the legislative authority of the Auditor-General appears to be sufficiently broad enough in scope to be viewed as encompassing administrative activities in courts or is yet to be challenged. Some audits involving management practices and subject matter quite removed from direct judicial decisions have proceeded following agreement between the parties, which was the position in Victoria before the Children's Court experience.

3.4.90 It is also relevant to mention that any action to separate for accountability purposes the judicial functions of courts and the administrative systems needed to support such functions would be consistent with the increasing emphasis placed by some courts within Australia on improving their accountability for the management of public moneys.

3.4.91 By way of illustration, the Federal Court's Chief Justice, in a September 1998 interview for a national newspaper, was cited in the newspaper as drawing a clear distinction between, on the one hand, judicial accountability through work done in public and judgements given on the public record but not subject to questioning except by appeal, and the managerial accountability which goes with responsibility for expending public funds. The Chief Justice was quoted by the newspaper as saying *"It's public money and we're a public institution. I don't regard reporting how we spend the money that parliament gives us as a threat to my independence"*.

3.4.92 In referring to the Federal Court, I should add that Court operates as a self-administered court, having been made responsible for its own administration in 1989. Most State courts remain administratively linked with the relevant government department within their jurisdiction.

3.4.93 The increasing focus on the managerial accountability of courts is also evident in moves taken in recent years by several courts to enhance their external accountability for financial and managerial performance. These moves have included:

- the development of corporate and business plans;
- the preparation and public release of annual reports;
- the issue of court charters or statements of commitment to service; and
- the appointment of public information officers.

3.4.94 These contemporary actions highlight the growing awareness by courts of their obligations for sound management of public funds. The involvement of the Auditor-General, as Parliament's auditor, in independently evaluating management practices in courts in a manner quite removed from judicial decisions would directly complement these emerging trends.

Legislative change seems the only way forward

3.4.95 When I advised the Department in February this year of my intention to inform the Parliament of the current position on this matter, I indicated it was my firm hope the Department and my Office could work positively together in the formulation of an effective solution.

3.4.96 One option cited to the Department was the reaching of agreement, in conjunction with the judiciary, on guiding principles which would enable the Auditor-General to examine, from time-to-time, the use of public funds in administrative or non-judicial activities within judicial bodies, without impinging on those areas which by their very nature involve the exercise of judicial power. If such an outcome was not possible, I considered legislative change may be the only viable option.

3.4.97 As mentioned in an earlier paragraph, the Department has indicated that its stance on this matter must always be in line with the June 1996 legal advice. As such, no action has transpired on the potential for formulation of guiding principles and I am now convinced the only means of remedying this unsatisfactory situation is by way of legislative amendment.

3.4.98 I therefore recommend that the Government move as quickly as possible to present to the Parliament amendments to the *Audit Act* 1994 which assign to the Auditor-General a power to audit, whenever deemed necessary, the administrative or non-judicial functions of all judicial bodies in Victoria.

3.4.99 I also consider it would be desirable, from the Parliament's perspective, for the Public Accounts and Estimates Committee to provide input on the matter and facilitate achievement of a timely and satisfactory outcome.

❒ ***RESPONSE*** *provided by Secretary, Department of Justice*

The separation of the judicial arm of government from both the Executive and Parliament is a fundamental tenet of the Westminster system of government. The judicial functions of courts and tribunals distinguish them from other government or public authorities that are normally considered to be within the purview of the Auditor-General. The Department of Justice believes a broadening of the Auditor-General's powers to conduct performance audits in the Supreme Court, County Court, Magistrates' Court or the Victorian Civil and Administrative Tribunal (VCAT) has the potential to undermine this important principle.

It is difficult to envisage how the conduct of performance audits of the administrative systems and processes of courts and tribunals could be adequately circumscribed to ensure review findings do not in any way reflect upon judicial processes and hence could be seen as intentionally or unintentionally compromising the judicial independence of Victoria's courts and tribunals. This was illustrated in the proposed report on the Children's Court which was based on the auditor's preference for an inquisitorial rather than an adversarial system. The report as proposed to be tabled was critical of and had the potential to undermine magistrates as a result of a fundamental misunderstanding of their role.

This is not to say the Courts and VCAT are unaware of their responsibilities and accountabilities as publicly funded organisation. Current accountability processes include:

- *the development of strategic plans and annual business plans (including detailed performance measures) for the services they deliver to the community of Victoria;*
- *regular reports to the Attorney-General on their operations and performance against plans;*
- *a comprehensive audit regime incorporating risk assessment, and regular and special audits of their administrative functions supported by the Department of Justice;*
- *participation in the audits of the annual financial statements of the Department of Justice conducted by the Auditor-General under the Financial Management Act 1994 and the Audit Act 1994;*
- *the annual provision of performance data to enable benchmark comparisons between States and Territories; and*
- *annual reports to Parliament.*

The most recent Report on Government Services published by the Council of Australian Government shows that the Courts and VCAT are to the forefront in effective and efficient service delivery to the community when compared to their interstate equivalents. The Attorney-General will continue to work with the Courts and VCAT to ensure they perform efficiently and effectively.

SCHEDULE A
STATUS OF MATTERS RAISED IN PREVIOUS REPORTS

Report	Subject	Status at date of preparation of this Report
	MATTERS RESOLVED OR ACTION COMMENCED	
DEPARTMENT OF JUSTICE		
Community Based Orders by Courts		
Ministerial Portfolios, May 1998, pp. 145-9.	The effectiveness of the administration of community correction services orders could be improved by greater care being taken to ensure that assessments to support the allocation of offenders to appropriate projects are adequately documented and there is effective monitoring of offenders' progress in meeting the requirement of the orders.	The Department has advised that systems and processes for the management of persons on community corrections services orders have been reviewed and enhancements are being implemented to improve assessments and allocation of offenders to programs and projects. In addition, a new software package is being introduced to facilitate better monitoring of offender compliance with orders.
Infants Investment Trust Accounts		
Ministerial Portfolios, May 1998, pp. 150-1.	Investment System enhancements should be implemented at the County Court and the Victims of Crime Assistance Tribunal to enable the regular production and issue of transaction statements to trust fund beneficiaries.	A departmental review of the constitutional, legislative and administrative framework, and the performance of the Courts in the management of funds held on behalf of minors and disabled persons has been completed. The recommendations emanating from the reviews are currently being considered by the Department of Treasury and Finance, Department of Justice, Supreme Court, County Court and Magistrates' Court.
SHERIFF'S OFFICE		
Ministerial Porfolios, May 1996, pp. 152-9.	The Department of Justice has over a number of years introduced various initiatives to improve its effectiveness in the enforcement and collection of fines and is considering a number of further initiatives.	A new Infringements Act is being drafted to clarify and broaden the range of sanctions and payment options available for fine defaulters and is expected to be introduced for consideration by the Parliament in the Spring 1999 parliamentary session. The redevelopment of Enforcement Management's systems is expected to be finalised by 31 August 1999 which will support more effective enforcement management.

SCHEDULE B
COMPLETED/INCOMPLETE AUDITS

Entity	Financial year/period ended	Reporting to Parliament	Financial statements signed by entity	Auditor-General's report signed
COMPLETED AUDITS				
Department of Justice	30 June 1998	31 Oct. *Financial Management Act* 1994, s.46.	28 Aug. 1998	31 Aug. 1998
ATTORNEY-GENERAL				
Equal Opportunity Commission	30 June 1998	" "	23 Sept. 1998	21 Oct. 1998
Legal Practice Board	30 June 1998	" "	22 Sept. 1998	25 Sept. 1998
Office of the Director of Public Prosecutions	30 June 1998	" "	14 July 1998	28 Aug. 1998
Office of the Legal Ombudsman	30 June 1998	" "	23 Sept. 1998	30 Sept. 1998
Office of the Public Advocate	30 June 1998	" "	28 Aug. 1998	16 Oct. 1998
Queen Victoria Women's Centre Trust	30 June 1998	" "	29 Sept. 1998	9 Oct. 1998
Victoria Legal Aid	30 June 1998	" "	9 Sept. 1998	11 Sept. 1998
Victorian Electoral Commission	30 June 1998	" "	11 Sept. 1998	23 Sept. 1998
Victorian Financial Institutions Commission	30 June 1998	" "	12 Aug. 1998	12 Aug. 1998
Victorian Institute of Forensic Medicine	30 June 1998	" "	28 Aug. 1998	5 Oct. 1998
POLICE AND EMERGENCY SERVICES				
Country Fire Authority	30 June 1998	" "	17 Aug. 1998	31 Aug. 1998
Metropolitan Fire Brigades Board	30 June 1998	" "	24 Aug. 1998	24 Aug. 1998
National Institute of Forensic Science	30 June 1998	No reporting requirements.	16 Oct. 1998	9 Nov. 1998
National Police Ethnic Advisory Bureau	30 June 1998	" "	31 Oct. 1998	13 Nov. 1998
Office of the Chief Commissioner of Police	30 June 1998	31 Oct. *Financial Management Act* 1994, s.46.	31 Aug. 1998	31 Aug. 1998
INCOMPLETE AUDITS				
AGRICULTURE AND RESOURCES				
Senior Master of the Supreme Court	30 June 1998	No reporting requirements. *(a)*		Incomplete

(a) Senior Master of the Supreme Court produces financial statements which are not a statutory requirement and these statements are audited by arrangement.

Part 3.5

Natural Resources and Environment

KEY FINDINGS

Water quality

- The microbiological quality of water in the Melbourne metropolitan area was assessed to be of a very high standard.

Paras 3.5.12 to 3.5.37

- Currently, the established guidelines provide that compliance will be deemed to be achieved where at least 90 per cent of water samples are assessed as satisfactory. However, in relation to up to 10 per cent of the water samples which are not assessed as satisfactory, little in the way of information is publicly available on the standard of the water provided, action taken to improve the poor quality of water where identified and the impact of this water on the public.

Paras 3.5.12 to 3.5.37

- As at 30 June 1998, around 40 per cent of country Victorians were still in receipt of drinking water which did not meet the microbiological requirements of the established guidelines and the level of compliance was 10 per cent lower than that projected by the Department of Natural Resources and Environment to be achieved by the end of 1999.

Paras 3.5.12 to 3.5.37

- Based on non-metropolitan water authorities' current business plan forecasts, the authorities will only achieve a compliance level of between 84 and 90 per cent with the microbiological component of the established water quality guidelines by the end of 1999 and as a result will not meet the State Government's water quality target of 100 per cent.

Paras 3.5.12 to 3.5.37

- While Melbourne Water and the 3 metropolitan retail water companies have in place emergency management plans, in excess of half of the 15 non-metropolitan water authorities had not finalised their plans.

Paras 3.5.46 to 3.5.49

KEY FINDINGS - *continued*

Sewerage treatment in non-metropolitan urban water industry

- Around 28 per cent of wastewater treatment plants fully met the standards outlined in the related EPA licence compared with only 13 per cent in the 1996-97 financial year.

Paras 3.5.60 to 3.5.66

- While the audit review concluded that progress was made during the 1997-98 financial year in the compliance of non-metropolitan water authority wastewater treatment plants with licensing conditions, significant improvement in compliance will only occur following the completion of major upgrades to treatment plants which are currently in progress.

Paras 3.5.60 to 3.5.66

- To ensure that their treatment plants are operating efficiently and effectively, authorities need to more closely monitor trade waste discharges so that any unauthorised discharges are identified and corrective action taken on a timely basis.

Paras 3.5.70 to 3.5.74

- Despite the identification of 60 towns which required the development of reticulated sewerage systems, at the date of preparation of this Report the EPA had not received any proposals for works related to the establishment of these systems.

Paras 3.5.67 to 3.5.69

Non-metropolitan urban water authorities - benchmarking of performance

- The Department needs to strengthen its non-metropolitan urban water authority monitoring function to ensure that all authorities meet the statutory reporting obligations in relation to performance information, to ensure the objectives of the Government's reform program are achieved.

Paras 3.5.78 to 3.5.81

- In order to effectively manage their water resources, water authorities need to identify the causes of unaccounted water and develop appropriate strategies to address the problems, where necessary.

Paras 3.5.82 to 3.5.106

- Following the provision of $410 million by the State Government in December 1997, authorities have steadily set about upgrading their infrastructure in order to significantly improve the quality of water they provide to the community and reduce the negative impact of wastewater discharges on the environment. At the same time, customers have benefited from a substantial reduction in charges.

Paras 3.5.82 to 3.5.106

- The performance of the non-metropolitan water authorities, with reference to return on assets and operational efficiency indicators, deteriorated during the 1997-98 financial year, with the quality of service marginally improved over this period. It is considered that the Government decision to reduce service charges and upgrade infrastructure have been a major determinant of these outcomes.

Paras 3.5.82 to 3.5.106

KEY FINDINGS - *continued*

Restoration of mining sites

- As a result of delays in undertaking inspections of mining sites, the Department cannot be assured that mining operators have rehabilitated sites in accordance with approved work plans and within a reasonable timeframe.

  Paras 3.5.109 to 3.5.124

- Given the potential safety risk to the community of unrehabilitated old mined or excavated sites, it is important that the Department identify and complete their restoration as soon as possible.

  Paras 3.5.109 to 3.5.124

- In order to ensure rehabilitation bonds are and continue to be sufficient to meet the costs of site rehabilitation, the Department should undertake bond reviews in a timely manner.

  Paras 3.5.125 to 3.5.149

3.5.1 The Minister for Agriculture and Resources and the Minister for Conservation and Land Management, have responsibility for operations within the Natural Resources and Environment sector. These Ministers have collective responsibility for the Department of Natural Resources and Environment.

3.5.2 Details of the specific ministerial responsibilities for public bodies within the Natural Resources and Environment sector are provided in Table 3.5A. These public bodies, together with the Department of Natural Resources and Environment, were subject to audit by the Auditor-General during the 1997-98 financial year.

TABLE 3.5A
MINISTERIAL RESPONSIBILITY FOR PUBLIC BODIES
WITHIN THE NATURAL RESOURCES AND ENVIRONMENT SECTOR

Ministerial portfolio	*Entities subject to audit*
Agriculture and Resources	Agriculture Victoria Services Pty Ltd
	Australian Food Industries Science Centre
	City West Water Ltd
	Emu Industry Development Committee
	First Mildura Irrigation Trust
	Food Quality Services Pty Ltd
	Food Science Australia
	Gippsland and Southern Rural Water Authority
	Goulburn Murray Rural Water Authority
	Melbourne Market Authority
	Melbourne Water Corporation
	Murray Valley Citrus Marketing Board
	Murray Valley Wine Grape Industry Development Committee
	Non-metropolitan water authorities (15)
	Northern Victorian Fresh Tomato Industry Development Committee
	Renewable Energy Authority of Victoria
	River management authorities (16)
	South East Water Ltd
	Sunraysia Rural Water Authority
	Veterinary Practitioners Registration Board of Victoria
	Victorian Dairy Industry Authority
	Victorian Dried Fruits Board
	Victorian Meat Authority
	Victorian Plantations Corporation
	Victorian Strawberry Industry Development Committee
	Water Training Centre
	Wimmera Mallee Rural Water Authority
	Yarra Valley Water Ltd

TABLE 3.5A
MINISTERIAL RESPONSIBILITY FOR PUBLIC BODIES
WITHIN THE NATURAL RESOURCES AND ENVIRONMENT SECTOR *- continued*

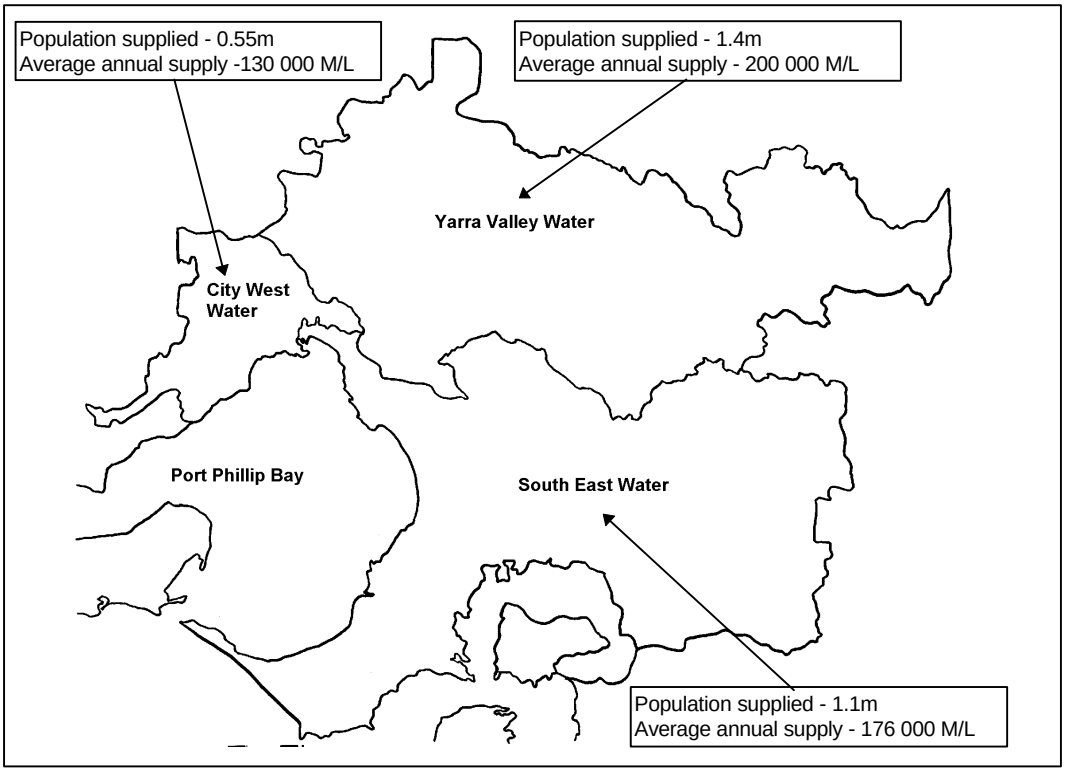
Ministerial portfolio	*Entities subject to audit*
Conservation and Land Management	Alpine Resorts Co-ordinating Council
	Regional waste management groups (16)
	Eco Recycle Victoria
	Environment Protection Authority
	Falls Creek Alpine Resort Management Board
	Lake Mountain Alpine Resort Management Board
	Melbourne Parks and Waterways
	Mount Baw Baw Alpine Resort Management Board
	Mount Buller Alpine Resort Management Board
	Mount Hotham Alpine Resort Management Board
	Mount Stirling Alpine Resort Management Board
	Parks Victoria
	Phillip Island Nature Park Board of Management
	Port Bellarine Committee of Management
	Royal Botanic Gardens Board
	Shrine of Remembrance Trustees
	State Swimming Centre Committee of Management
	Surveyors Board of Victoria
	Trust for Nature (Victoria)
	Yarra Bend Park Trust
	Zoological Parks and Gardens Board

3.5.3 Comment on matters of significance arising from the audit of entities within the Natural Resources and Environment sector is provided below.

WATER QUALITY

3.5.4 Victoria's water industry is divided into 3 major sectors, namely, the metropolitan, non-metropolitan urban and the rural water sectors. The metropolitan water sector consists of 3 retail water companies which provide water and sewerage services to the public and the Melbourne Water Corporation (Melbourne Water), which provides wholesale water and sewerage services, and drainage services. Details of the areas serviced by the 3 retail companies are outlined in Chart 3.5B.

CHART 3.5B
AREA SERVICED BY METROPOLITAN RETAIL WATER COMPANIES



3.5.5 The non-metropolitan urban water sector consists of 15 water authorities which provide water and sewerage services to approximately 1.1 million country Victorians. There is also a collection of other public and private bodies providing drinking water in mainly tourist areas such as in national parks and alpine resorts.

3.5.6 The third component of the State's water system is the rural water sector. The primary role of this sector is to supply Victoria's agricultural community with water for irrigation, and stock and domestic purposes.

The community expectation is that the quality of drinking water should be of a high standard.

3.5.7 From an overall management perspective, to ensure that there is a high quality of drinking water provided by water authorities, it is important that an overall program of water management covering water quality from its source to the consumer's tap is in place which would include:

- appropriate Statewide water policies to integrate planning, management and development of catchment areas to protect surface and groundwater resources;
- effective planning, incorporating water management plans which identify all source water areas, threats to water quality and strategies for the ongoing management of the conditions and activities within catchment areas that can affect the quality of source water;
- sound catchment management to preserve protected catchments and to minimise the risk of contaminated water from unprotected catchments;
- effective water treatment to improve the quality of water where source water is not of an acceptable standard;
- adequate maintenance of distribution systems to prevent water contamination as it travels from storages to the consumer;
- comprehensive standards for water quality;
- effective mechanisms to progressively monitor and assess the quality of water as it moves through the distribution system and appropriate strategies to address problems which arise;
- public awareness in respect of the current standard of water quality, the impact of water quality on the community and the costs associated with improving water quality; and

- adequate research into the effects of micro-organisms and chemicals in drinking water on human health and appropriate cost-benefit analysis to determine the appropriateness of additional water treatment designed to reduce the level of micro-organisms.

3.5.8 The Auditor-General's May 1998 *Report on Ministerial Portfolios* provided detail comment on the quality of drinking water provided by non-metropolitan water bodies and outlined the following key issues:

- only 57 per cent of the population supplied by non-metropolitan water authorities received water that met the World Health Organisations 1984 guidelines for microbiological quality;
- the estimated cost associated with raising the quality of water to a standard consistent with the guidelines was in the order of $288 million; and
- although the Government's reform agenda envisaged the issue of licences to authorities by July 1995, licences had not been issued by the Government as the requisite legislative amendments had not been made to establish such arrangements.

3.5.9 **Given the above findings, and the importance of this issue from a public interest perspective, audit undertook a follow-up review specifically focusing on the establishment of water quality standards and the assessment of water quality against those standards, covering both the metropolitan and non-metropolitan water authorities.**

Quality of drinking water

3.5.10 There are currently no generally accepted legally binding standards governing drinking water quality in Victoria. Instead, the following 2 guidelines, each having different requirements regarding the microbiological quality and physical, chemical and aesthetic quality of drinking water, are utilised:

- *World Health Organisation's (WHO) 1984 Water Quality Guidelines; and*
- *National Health and Medical Research Council (NHMRC) and the Australian Water Resources Council Guidelines for Drinking Water Quality in Australia, 1987.*

3.5.11 The *WHO 1993* guidelines (an updated version of the *WHO 1984* guidelines) have been modified for Australian conditions by NHMRC and *the Agriculture and Resources Management Council of Australia and New Zealand* to create *Australian Drinking Water Guidelines (ADWG) 1996,* which the State Government is currently considering for adoption in Victoria.

Microbiological quality

The microbiological guidelines seek to ensure that drinking water supplied to consumers is free of harmful micro-organisms which can cause disease. The microbiological quality of water is determined by measuring the levels of coliform organisms in water samples. Coliforms are bacteria which occur in very high numbers in the faeces of warm blooded animals.

Both water quality guidelines provide 2 tests designed to measure the coliform levels in drinking water. The first of these tests measures the existence of "thermo tolerant" coliforms (faecal or E.coli) and the second measures the presence of all coliforms.

Physical and chemical quality

Indicators of physical quality, considered by the NHMRC 1987 guidelines to be non-health related, include pH, colour, and turbidity. The pH levels have little direct health effects, however, high pH levels can reduce the effectiveness of disinfection and low pH levels can contribute to the encrustation and corrosion of pipes and reticulation systems.

Coloured water may result from dissolved iron, manganese or complex organic compounds and as a result requires higher levels of disinfectant.

Turbidity measures the extent of fine suspended solids in water. High levels of suspended solids may protect pathogenic micro-organisms from the effects of the disinfection process and promote bacterial growth.

Chemicals may naturally occur in water (e.g. minerals), result from water treatment (e.g. aluminium, chlorine, trihalomethanes), agricultural or mining activities (e.g. pesticides) or be added for preventative health reasons (e.g. fluoride).

Testing and monitoring of water quality

Metropolitan water sector

3.5.12 The 3 retail water companies are required, under their licence agreements and customer charters, to provide water which:

- is clear and free from objectionable odour and taste;
- meets the health-related parameters of the NHMRC 1987 guidelines; and
- is at least of equal quality to that provided by Melbourne Water before the retail water companies began operating on 1 January 1995.

3.5.13 The Victorian Government is considering whether the current arrangements, where drinking water quality standards are incorporated into operating licenses, is an appropriate mechanism for ensuring compliance with these standards.

3.5.14 In accordance with its 1997-98 Memorandum of Understanding with the Department of Human Services, Melbourne Water was required to:

- provide high quality drinking water that consistently meets the NHMRC 1987 guidelines, as defined in the operating licences of the retail water companies; and
- undertake water quality monitoring and testing using independent laboratories accredited by the Department of Human Services.

3.5.15 **This Memorandum of Understanding expired in August 1998 and at the date of preparation of this Report had not been renegotiated.**

3.5.16 The NHMRC 1987 guidelines were intended to provide:

- day-to-day operational values which ensure the water supplied does not carry any significant risk to the consumer;
- a basis for the design and planning of water supply augmentation and water quality improvement works; and
- a benchmark for assessing long-term trends in the performance of the system.

3.5.17 The microbiological component of the guidelines require no faecal or other coliforms per 100 millilitres of water to be identified in 95 per cent of water samples, but allow a lower standard requiring 90 per cent of samples to have no more than 20 total coliform organisms, where the microbiological risk to water quality is considered to be low, such as where water is sourced from protected catchments and other conditions are met.

3.5.18 The operating licences and associated customer charters of the retail water companies, require them to meet the health related parameters for water quality set out in the NHMRC 1987 guidelines.

3.5.19 The retail water companies licence agreements require them to engage accredited water testing laboratories to undertake a systematic program of water sampling in accordance with the Health (Quality of Drinking Water) Regulations 1991 and to test the microbiological quality of each sample against the NHMRC 1987 guidelines.

3.5.20 In addition, the results of the water quality testing undertaken by each company are also required to be reported to the Office of the Regulator-General within 3 months following the end of each financial year and to be made publicly available.

3.5.21 In order to facilitate the water quality monitoring program, the areas serviced by the retail water companies has been divided into 68 geographic zones. A zone usually consists of an area with a population of less than 150 000 people, where the water supplied to consumers could reasonably be expected to be of a similar quality.

3.5.22 Melbourne Water is also required to undertake a systematic program of water sampling in accordance with the Regulations and continues to comply with the 1987 NHMRC guidelines, in accordance with its 1997-98 Memorandum of Understanding.

Regular testing of water is essential to ensure the provision of high quality water to all Victoria. (Photo courtesy of Melbourne Water.)

Microbiological quality

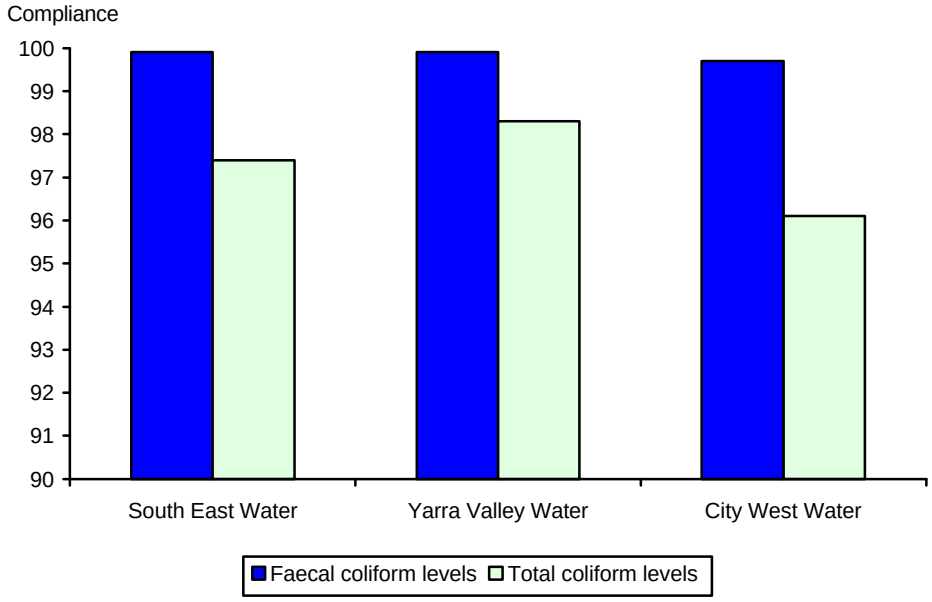
3.5.23 During the 1997-98 financial year, the 3 retail water companies tested more than 10 000 water samples drawn from their respective water supplies for both faecal coliforms and total coliforms. **The microbiological quality of water in the Melbourne metropolitan area was assessed to be of a very high standard, with 99.9 per cent of water sampled complying with the guidelines for faecal coliforms and 97.6 per cent of samples complying with the guidelines for total coliforms**. The compliance results for faecal coliforms and the total coliforms represented an improvement of 0.4 and 0.1 per cent, respectively, over the previous year.

3.5.24 **Based on information provided by the retail water companies, 8 per cent of Melbourne's population are provided with water which does not meet the NHMRC guidelines.**

3.5.25 **Currently, the guidelines provide that compliance will be deemed to be achieved where at least 90 per cent of water samples are assessed as satisfactory. However, in relation to up to 10 per cent of the water samples which are not assessed as satisfactory, little in the way of information is publicly available on the standard of the water provided, action taken to improve the poor quality of water where identified and the impact of this water on the public.**

3.5.26 Details of the level of compliance by the 3 retail water companies during the 1997-98 financial year are outlined in Chart 3.5C.

CHART 3.5C
RETAIL WATER COMPANIES
MICROBIOLOGICAL WATER QUALITY,
1997-98 FINANCIAL YEAR
(per cent)



3.5.27 Unlike the 3 retail water companies, which are required to report the results of their water testing program to the Office of the Regulator-General by 30 September each year and the Department of Human Services each month, no such requirement to report within this timeframe applies to Melbourne Water.

3.5.28 **At the date of preparation of this Report, the Corporation had not finalised its water quality report for the 1997-98 financial year.**

Physical and chemical quality

3.5.29 The audit review of water testing undertaken by the 3 retail water companies disclosed that for the 1997-98 financial year, 35 per cent of the 68 metropolitan water quality zones tested for pH, turbidity, colour, iron, aluminium and fluoride failed to achieve one or more of the specific standards contained in the NHMRC 1987 guidelines for these characteristics in respect of all samples taken. As illustrated in Table 3.5D, the failure rate varies from 13 per cent for aluminium to 35 per cent for pH and fluoride.

TABLE 3.5D
RETAIL WATER COMPANIES
PHYSICAL AND CHEMICAL WATER QUALITY,
1997-98 FINANCIAL YEAR
(per cent)

Category	*Failure to meet standard*
pH	*(a)* 35
Fluoride	35
Iron	*(a)* 17
Turbidity	*(a)* 15
Colour	*(a)* 14
Aluminium	*(a)* 13

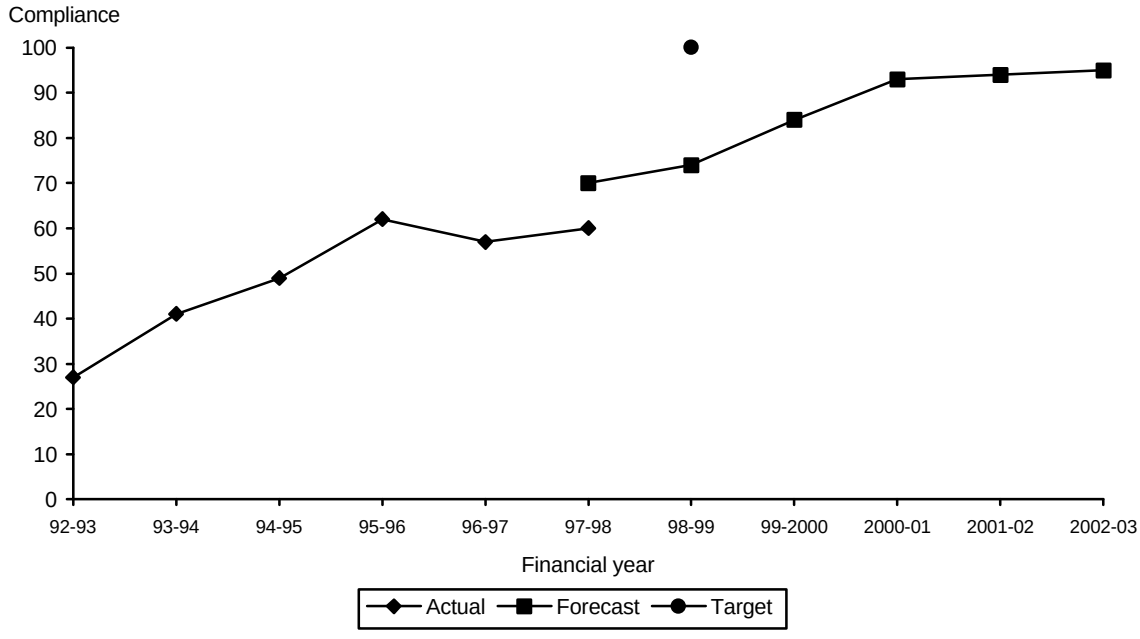
(a) Classified as non-health related parameters under the NHMRC 1987 guidelines.

Non-metropolitan water sector

3.5.30 As with the metropolitan water sector, accredited water testing laboratories are engaged by non-metropolitan water authorities, to undertake a systematic program of water sampling in accordance with the Regulations. However, the quality of water supplied by the Authorities is tested against the WHO 1984 guidelines rather than the NHMRC 1987 guidelines.

3.5.31 The sector's overall compliance with the microbiological component of the WHO 1984 guidelines over the last 5 years is outlined in Chart 3.5E.

CHART 3.5E
NON-METROPOLITAN WATER AUTHORITIES,
MICROBIOLOGICAL WATER QUALITY(PERCENTAGE OF POPULATION RECEIVING WATER WHICH MEETS "WHO 1984" GUIDELINES)
(per cent)



3.5.32 Chart 3.5E shows that there has been significant improvement in the quality of water provided to consumers by authorities, from 27 per cent in the 1992-93 financial year to 60 per cent in the 1997-98 financial year.

3.5.33 **However, as at 30 June 1998, 40 per cent of country Victorians were still in receipt of drinking water which did not meet the microbiological requirements of the WHO 84 guidelines and the level of compliance was 10 per cent lower than that projected by the Department of Natural Resources and Environment (using information from the business plans of water authorities) to be achieved by the end of 1999.**

3.5.34 Discussions with the Department indicated that the lower than expected level of compliance was primarily due to contract and construction lead-time delays for plant improvement works, and longer than expected commissioning time before water quality would fully comply with WHO 1984 guidelines.

3.5.35 **Chart 3.5G also indicates that, based on authorities' current business plan forecasts, the authorities will only achieve a compliance level of between 84 and 90 per cent with the microbiological component of the WHO 84 water quality guidelines by the end of 1999 and as a result will not meet the State Government's water quality target of 100 per cent.**

3.5.36 The audit review also disclosed that:

- A significant proportion of the water that did not meet the guidelines for microbiological quality was of a particularly poor quality. Of particular concern was that 38 per cent of treated water which is regarded as disinfected, did not meet the guidelines. This result suggests that the water treatment plants managed by authorities were either not operating effectively or contamination occurred in other areas such as open storage and tanks;
- There was no independent sampling or verification of the samples taken by each Authority, similar to the operational audits undertaken by independent contractors and subject to review by the Regulator-General in the metropolitan water sector;
- During the period July 1995 to June 1997, testing disclosed that 286 towns (77 per cent) examined for physical, chemical and radiological characteristics failed one or more of the specific tests in the WHO 1984 guidelines;
- The results of microbiological water testing by authorities are reported annually, however, the results of physical and chemical testing are only reported biannually which, in audit's opinion, does not allow for timely reporting and analysis of these results;
- Authorities currently report the microbiological quality of their water, together with details of their pH, turbidity and colour in their annual reports, however, in relation to other important indicators, such as the level of chemicals in the water, there is no disclosure; and
- The cost associated with raising the microbiological quality of water to a standard consistent with the guidelines was estimated by the Department to be in the order of $362 million.

3.5.37 However, an audit review of the authorities business plans identified the following major initiatives by the Barwon, Coliban and Central Highlands regional water authorities, 3 of the largest non-metropolitan water authorities which will improve water quality in these regions:

- **Barwon Regional Water Authority** has entered into a contract to have the She Oaks water treatment plant constructed, which will provide fully-treated water to 102 000 people in Geelong's Lovely Banks zone. This plant is likely to be completed in the fourth quarter of the 1999 calendar year but not fully commissioned until March 2000, after which a reticulation mains flushing and cleaning program will be undertaken. As there are approximately 450 km of mains required to be cleaned, the water quality in this zone will not meet the target until the 2002-03 financial year;
- **Coliban Regional Water Authority** has recently announced details of its financial arrangements with a private sector organisation to construct a treatment plant to service Bendigo, Castlemaine, Kyneton and Taradale which is expected to provide water to 85 000 people. The plant is not expected to be operational until the end of 1999; and
- **Central Highlands Regional Water Authority** has entered into a financial arrangement with a private sector organisation to build water treatment plants, which will provide treated water to 85 000 customers. The plants are not expected to be completed until the year 2000.

Implementation of licence agreements

3.5.38 As indicated in the Auditor-General's May 1998 *Report on Ministerial Portfolios,* licence agreements between the State Government and individual non-metropolitan water authorities were to be established as part of the Government's water reform program to improve the level of accountability and customer service, and to establish performance standards for the industry.

3.5.39 The implementation of these licenses has been deferred pending the Government's review of the current regulatory framework in the water sector. **As part of this review process, consideration should be given to the establishment of licence agreements which would require authorities to comply with established water quality standards.**

Creation of a drinking water inspectorate

3.5.40 The Regulator-General's July 1997 to June 1998 report on the performance of the 3 retail water companies indicated that his current role of overseeing licensee compliance with water quality guidelines did not constitute part of his primary function of economic regulator for the water sector. Furthermore, the Regulator-General recommended that responsibility for regulating water quality should be consolidated into a single body which monitors the quality of water against established quality standards, along the lines of the United Kingdom's Drinking Water Inspectorate. If implemented, this recommendation would bring the water sector in line with the structure adopted for the Victorian energy industries for safety regulation and would be consistent with the establishment of the Office of Chief Electrical Inspectorate and the Office of Gas Safety in the power and gas industries, respectively.

3.5.41 **Consideration should be given to the establishment of a separate body to monitor the quality of water provided by the entire water sector.**

Effectiveness of water testing programs

3.5.42 As indicated earlier in this Report, around 8 per cent of the metropolitan population and around 40 per cent of country Victorians are in receipt of water which does not meet the respective water quality guidelines. However, audit was not able to obtain information to determine the effect of non-compliance, if any, on the health and wellbeing of the general public.

3.5.43 The Department of Natural Resources and Environment anticipates that a 3 year study currently undertaken by the Co-operative Research Centre for Water Quality and Treatment and funded by public and private sector entities, Melbourne Water, the Department of Human Services and the 3 retail water companies, will provide objective information regarding the health effects of water on Victorian families.

3.5.44 Currently, in excess of $5 million is spent on an annual basis in testing, analysing and reporting on water quality. Furthermore, the water industry spends hundreds of millions of dollars on building and upgrading water treatment plants to ensure that water supplies meet established guidelines.

3.5.45 **Discussions with Melbourne Water indicated that for the metropolitan water system to move from compliance with the current NHMRC 1987 guidelines to compliance with the updated ADWG 1996 guidelines, would require full water treatment of all Melbourne's water supplies and additional testing and reporting of water quality, at a cost of approximately $500 million in present value terms.**

Managing water-related emergencies

3.5.46 Major emergencies involving drinking water quality are managed in accordance with the broader emergency management arrangements within the State of Victoria and in particular in accordance with the State Government's *Emergency Management Manual Victoria.*

3.5.47 The primary responsibility for managing disasters rests with the water authorities, which are required to have emergency management plans developed to deal with such events. If there is a public health threat, authorities are required to consult with the Department of Human Services, which may assume responsibility for any public announcements, additional drinking water testing or public restrictions.

3.5.48 **The audit review disclosed that while Melbourne Water and the 3 metropolitan retail water companies have in place emergency management plans, in excess of half of the 15 non-metropolitan water authorities had not finalised their emergency management plans at the date of preparation of this Report.**

3.5.49 **Given the significance of this issue, a high priority needs to be given to the finalisation of appropriate emergency management plans for the water sector.**

❒ ***RESPONSE*** *provided by Secretary, Department of Natural Resources and Environment*

Quality of drinking water

Compliance with microbiological health-related guidelines is a legally binding licence condition for the metropolitan retail companies and is a requirement placed upon the non-metropolitan urban water authorities under the in Memoranda of Understanding with the State Government. The Department of Natural Resources and the Water Reform Unit of the Department of Treasury and Finance are currently reviewing the regulatory framework for water quality.

Testing and monitoring of water quality - microbiological quality

The 8 per cent of Melbourne's population that does not receive water, which meets the microbiological requirements of the NHMRC guidelines, are mostly in "water quality improvement zones" where works are in progress to address the situation. The retailers' operating licences specify these zones and require achievement of the NHMRC guidelines within given timeframes negotiated as part of the licence agreement.

This audit conclusion in paragraph 3.5.25 is not correct. The 3 metropolitan retail companies publish annual water quality reports including summary compliance information for all zones (including improvement zones) under their management. This information is readily obtainable from the retail water companies. In addition, information on these matters is also contained in the Regulator-General's performance report on Melbourne's retail water and sewerage companies.

Testing and monitoring of water quality - physical and chemical quality

While the fluoride level is a health-related guideline, the 35 per cent failure rate would most likely represent underdosing rather than the overdosing. Overdosing poses a greater risk to the community.

❒ ***RESPONSE*** *provided by Secretary, Department of Natural Resources and Environment - continued*

Non-metropolitan water sector

There has been significant improvement in the quality of non-metropolitan water and wastewater as a result of the Government's water reforms including the $410 million provided in 1998 for non-metropolitan water and wastewater improvements.

While some of the works have been delayed, the objective of achieving WHO drinking water quality standards will be substantially achieved by December 2000. The reasons for audit's lead conclusion that the authorities will only achieve "84 to 90 per cent" compliance with WHO guidelines are stated subsequently in the Report. The reasons relate to the finalisation of BOOT projects at Coliban and Central Highlands. It was essential that the final agreements clearly define the financial and risk sharing relationships between the BOOT provider and the authority. The BOOT process has led to significant cost savings to the authorities and their customers (estimated at up to $7 million for Central Highlands), as well as the opportunity to benefit from the latest developments in water treatment technology.

Implementation of licence agreements

Consideration of the future of operating licences is being undertaken as part of the review of the regulatory framework for the water industry. Nevertheless, authorities are required to achieve agreed targets for water quality through existing directions made pursuant to the Water Act 1989 and their Memorandum of Understanding with the Government.

Creation of a drinking water inspectorate

This proposal is currently being considered as part of the review of the regulatory framework.

Effectiveness of water testing programs

As indicated earlier in audit's Report, the microbiological quality of water in the Melbourne metropolitan area is of a high standard and the benefits of incurring costs in the order of $500 million to further improve it to ADWG 1996 standards are not clearly established. Other options (including a number not requiring extensive capital works) which would satisfy key requirements of ADWG 1996 need to be examined and evaluated.

Managing water related emergencies

In accordance with the Emergency Management Manual of Victoria, DHS is the lead agency where contamination incidents in drinking water pose a risk to public health. Formal protocols are being developed which will clearly indicate the responsibilities of DHS, EPA, NRE, water authorities and other relevant bodies when other water related emergencies occur.

❒ ***RESPONSE*** *provided by Secretary, Department of Human Services*

Testing and monitoring of water quality

All water authorities in Victoria, including Melbourne Water, the metropolitan water companies and the non-metropolitan urban water authorities, must comply at all times with the provisions of the Health (Quality of Drinking Water) Regulations 1991 and, where applicable to them, the Health (Fluoridation) Act 1973.

These requirements oblige water authorities in Victoria to monitor and report to the Department in a prescribed manner. Statutory requirements such as these are not affected by virtue of being mentioned in, or omitted from, other subordinate documents (such as licences or any Memorandum of Understanding).

In general, Memoranda of Understanding are not appropriate instruments for defining the relationship between the Department of Human Services and water authorities, given the nature of the regulatory environment that has been established in Victoria.

The conclusion in the Report that there is little publicly available information regarding the microbiological quality of Melbourne's water supply is incorrect. Detailed information is readily available in the water quality reports published annually by the Office of the Regulator-General and the metropolitan retail water companies.

With regard to Table 3.5D, the statement re fluoride would represent fluoride underdosing by Melbourne Water, not overdosing. However, the Report does not clearly explain the significance of the data in the table or how it was calculated, so more detailed comment can not be provided. Further, the guideline values for aluminium and iron in NHMRC 1987 are clearly identified in that document as being "not directly health-related".

Effectiveness of water testing programs

The Department agrees that it is often difficult to obtain information on the effect of particular instances of water quality non-compliance on public health. However, this would usually be due to inherent limitations in the techniques by which health-related information is gathered rather than there being no link between water supply systems and community health. There is a considerable worldwide body of evidence that improvements in drinking water quality lead to improved health and customer wellbeing. This fundamental principle underpins all scientific drinking water guidelines worldwide, including ADWG 1996, NHMRC 1987, WHO 1984 and WHO 1993.

The stated cost estimate of around $500 million for the metropolitan system is believed to relate to an estimated upper-limit of costs, assuming that extensive capital works are introduced. The Department is unaware of any independent or robust assessment that has verified the components of this estimate. The actual costs for the metropolitan area will depend on the works necessary for the water companies to be able to demonstrate essential minimisation of risk (particularly microbiological risk) from catchment all the way to consumer supplies.

The Department has significant concerns that failing to refer to other options, and the emphasis on an unverified upper cost estimate, is misleading. This section also fails to distinguish between the existing expenditure on works in the non-metropolitan water sector and possible works in the metropolitan water sector.

❒ ***RESPONSE*** *provided by Secretary, Department of Human Services - continued*

The 3 year research study mentioned in this section is also jointly funded by a range of other parties, including this Department.

General comments

The ADWG 1996 guidelines referred to throughout the Report supersede the NHMRC 1987 guidelines. They have been prepared with extensive co-operation by the Australian water industry, including Melbourne Water at the time, and represent the most appropriate source of information at the present time for drinking water quality in this country.

The metropolitan licences were principally based on elements of the NHMRC 1987 guidelines because these guidelines applied to the metropolitan water supply system at the time the licences were originally prepared (in 1994). This was prior to the publication of ADWG 1996. As correctly identified in the Report, the Government is considering the best way in which the ADWG 1996 guidelines can be introduced for Victoria.

SEWERAGE TREATMENT IN NON-METROPOLITAN URBAN WATER INDUSTRY

3.5.50 As indicated previously in this Report, the non-metropolitan water sector consists of 15 water authorities which provide water and sewerage services to 1.1 million country Victorians and generate $380 million in revenue each year from an asset base valued at approximately $4.3 billion.

3.5.51 Effective wastewater management is a key responsibility of non-metropolitan water authorities and is integral to public health and the health of Victoria's rivers and streams. Statutory requirements for the protection of environmental quality and the management of wastes are set out in policies gazetted under the *Environment Protection Act* 1970. These policies assist in the provision of appropriate sewerage services by:

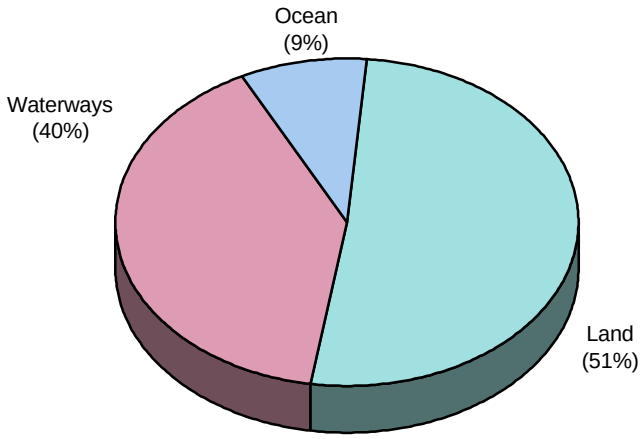
- advocating the provision of reticulated systems for areas of need;
- utilisation of sewers for the disposal of wastewater once a service has been provided;
- appropriate controls to ensure the safety of industrial discharges to sewerage systems;
- effective treatment and management of effluent so as to ensure surface waters, groundwater and land are not polluted; and
- stipulating minimum standards for the treatment of sewage.

3.5.52 There are broadly 3 levels of sewage treatment, namely:

- primary - removal of floatable and settleable solids;
- secondary - reduction of biochemical oxygen demand, suspendable solids and bacteria; and
- tertiary - further reduction of bio-degradable material and significant nutrient removal.

3.5.53 The minimum acceptable treatment of sewage in Victoria is secondary treatment, with the standards for each treatment plant's effluent discharges set out in its licence agreements with the EPA. The location of these discharges, which can be to land, sea or to waterways is disclosed in Chart 3.5F.

CHART 3.5F
LOCATION OF WASTEWATER TREATMENT PLANT DISCHARGES
(per cent)



Note: Some plants discharging to waterways also reuse part of their effluent.

3.5.54 Monitoring procedures incorporated into EPA licences require the quality and quantity of effluent discharges to be tested on a regular basis and for the analysis of effluent quality to be undertaken by a National Association of Testing Authorities (NATA) accredited laboratory.

3.5.55 The EPA has developed a series of self-monitoring programs to ensure effluent discharges from wastewater treatment plants met the standards outlined in their EPA licence. These programs required licensees to:

- immediately report any emergency situation;
- provide monthly reports on breaches of effluent discharge standards; and
- compile an annual summary report of overall performance.

3.5.56 Once the EPA is satisfied that these programs were working effectively, its monitoring role is reduced to annual licence compliance inspections and occasional spot checks during the year.

3.5.57 Following annual inspections of compliance by the EPA, a list of poorly performing treatment plants are identified and appropriate action taken, which generally involves obtaining agreement from the offending authorities to upgrade their facilities and management practices, but can include financial penalties or prosecution.

3.5.58 The May 1998 *Report on Ministerial Portfolios,* commented on the State Government's reform process in the non-metropolitan water sector and in particular on the level of compliance of wastewater treatment plants with EPA licence agreements. Specifically, it was reported that:

- only 13 per cent of wastewater treatment plants operated by non metropolitan water authorities fully met the EPA standards outlined in their EPA licence for the discharge of treated wastewater into waterways;
- the estimated cost associated with upgrading the wastewater treatment plants to comply with EPA standards was in the order of $167 million; and

- the State Government's October 1997 water reform package had provided $410 million to these authorities, which in part was intended to upgrade existing infrastructure in order to reduce the negative impact of discharges from wastewater treatment plants on the environment.

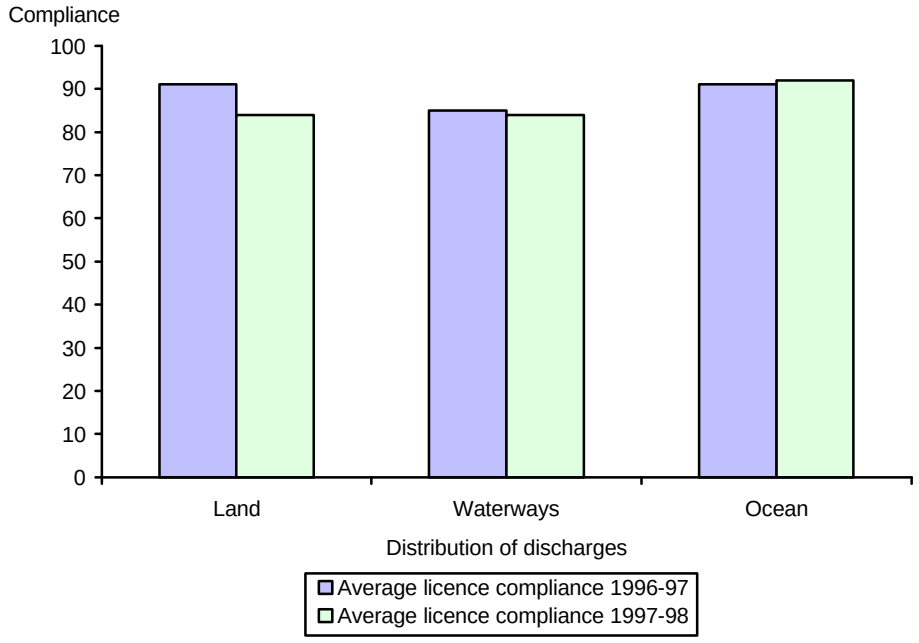
3.5.59 Audit undertook a follow-up review to assess the extent to which these issues have been addressed since my previous Report.

Compliance with EPA licences

3.5.60 Audit analysis of information provided by the EPA and the Department of Natural Resources and Environment, which is responsible for the provision of strategic policy advice on water reform issues to the Government, regarding the compliance of non-metropolitan water authorities with EPA licences during the 1997-98 financial year disclosed that Authorities achieved on average 87 per cent compliance with the waste discharge standards specified in their EPA licences.

3.5.61 The respective levels of compliance by authorities in relation to discharges to waterways, land and sea achieved during the 1996-97 and 1997-98 financial years are outlined in Chart 3.5G.

CHART 3.5G
WASTEWATER TREATMENT PLANT COMPLIANCE
WITH EPA LICENCE AGREEMENTS, 1996-97 AND 1997-98
(per cent)



Note: Some plants discharging to waterways also reuse part of their effluent.

3.5.62 **Chart 3.5G illustrates that while the average compliance for discharges to waterways and to sea has remained relatively stable since the 1996-97 at around 85 and 91 per cent compliance, respectively, the level of compliance in relation to discharges to land has deteriorated by 7 per cent to 84 per cent, respectively.**

3.5.63 The audit review of information available on effluent discharges for the 1997-98 financial year also disclosed that:

- **Around 28 per cent of wastewater treatment plants fully met the standards outlined in their EPA licence compared with only 13 per cent in the 1996-97 financial year.** Although this result represents a significant improvement since the previous financial year, the performance of these plants can be contrasted to that of the metropolitan system, where all their wastewater treatment plants have effectively achieved 100 per cent compliance;
- **There were 53 treatment plants with compliance of 90 per cent or less. The EPA has indicated that 31 of these plants were likely to have fundamental deficiencies** preventing full licence compliance being achieved and either require improvement or co-ordination with local industries where discharges from these industries were overloading the plants. Furthermore, where the discharges from these plants were to waterways, the EPA considered that in a number of cases these discharges are likely to have significant adverse effects on the environment; and
- An analysis undertaken by the Department concluded that 65 per cent of the rural population served by non-metropolitan water authorities had wastewater treated by complying treatment plants in the 1997-98 financial year, which represented an increase over the 1996-97 financial year, where the level of compliance was 52 per cent.

3.5.64 The audit also identified that the EPA's use of non-regulatory measures such as obtaining agreement from authorities to upgrade treatment plants in order to rectify existing deficiencies, education of Authority staff, the provision of information, technical advice on licence compliance and promotion of environment improvement plans, and environmental audits, did not have any significant impact on improving the quality of discharges from treatment plants.

3.5.65 **While the audit review concluded that progress was made during the 1997-98 financial year in the compliance of non-metropolitan water authority wastewater treatment plants with licensing conditions, significant improvement in compliance will only occur following the completion of major upgrades to treatment plants which are currently in progress.**

3.5.66 **Each of the authorities have entered into a memorandum of understanding with the State Government which, among other things, requires authorities to have all of their wastewater treatment plants complying with the EPA licences by the year 2001. However, information contained in the authorities' 1998-99 business plans indicated that 6 per cent of the population will not be served by complying treatment plants by the year 2001 and, as a result, the Government's target is not likely to be achieved.**

Upgrading of sewerage systems

3.5.67 The State Government's policy provides that, in the absence of a specific exemption from the EPA, reticulated sewerage systems are to be established in all towns with 500 or more residents by the year 2001. This policy was designed to overcome the potential negative impact on public health and the environment of a significant number of failing or faulty septic systems currently operating in country Victoria. Where these systems require treatment plants, proposals for these plants need to be forwarded to the EPA for approval.

Upgraded facilities at the Portland Coast Region Water Authority wastewater treatment plant.

3.5.68 **Despite the identification of 60 towns which required the development of reticulated sewerage systems, at the date of preparation of this Report the EPA had not received any proposals for works related to the establishment of these systems.**

3.5.69 While the EPA does not have legislative power to direct authorities to establish reticulated sewerage systems, its strategy has been to promote the advantages to local communities of such systems. However, authorities have experienced strong opposition from many of their local communities to the introduction of reticulated sewerage systems, due to the additional costs to local residents.

Industrial discharges into sewerage systems

3.5.70 As wastewater treatment plants are primarily designed for the treatment of domestic wastewater and not industrial waste, such discharges can corrode sewers, cause blockages and hydraulic surcharges, overload the capacity of the treatment works, contaminate effluent discharges and be harmful to treatment plant operators or the treatment process. Therefore, care needs to be taken to ensure appropriate controls are established to manage the discharge of industrial waste into sewers.

3.5.71 Where industrial discharges into sewerage systems occur, they are generally subject to formal agreements that specify the nature and amount of waste that may be discharged, to ensure that these discharges are kept within the capacity of the system. Where agreement cannot be reached with the respective water authority in respect of industrial discharges into sewerage systems, the organisation involved must make its own arrangements to have its discharges appropriately treated.

3.5.72 Unauthorised discharges are the responsibility of water authorities. However, where the discharge causes pollution, the EPA can intervene and issue an Abatement Notice to the offending organisation under section 28B of the *Environment Protection Act* 1970. Such a notice requires the organisation to cease or reduce its industrial discharges into the sewerage system. Unauthorised discharges are heavily penalised and often involve the closing down of offending organisations until the problem is resolved to the satisfaction of the water authorities.

3.5.73 The audit review identified that, in respect of 13 treatment plants, industrial waste discharges into sewerage systems were a major factor in these plants not complying with their EPA licences during the 1997-98 financial year. Furthermore, in 2 instances, the EPA was forced to directly intervene to restrict these industrial discharges and, in one of these cases both the company and the water board were prosecuted for causing pollution.

3.5.74 **To ensure that their treatment plants are operating efficiently and effectively, authorities need to more closely monitor trade waste discharges so that any unauthorised discharges are identified and corrective action taken on a timely basis.**

❒ ***RESPONSE*** *provided by Secretary, Department of Natural Resources and Environment*

Compliance with EPA licences

Experience of water businesses in Victoria is that EPA non-regulatory measures are effective. For example, Goulburn-Valley Water has a non-regulatory agreement with EPA for the upgrade of the Shepparton Wastewater Plant, the largest in inland Victoria. This commits the Authority to a $20 million upgrade program for the site which will directly improve wastewater quality. A further $25 million is planned to be expended in 11 southern region towns with the agreement of EPA.

Improvements indicated above are generally in line with program forecasts as developed in the water reform package. The progress towards achieving compliance goals is stepped in relation to the commissioning of treatment plants. Future corporate plans will be required to address measures necessary to reach the 2001 compliance target.

Upgrade of sewerage systems

This conclusion misunderstands the process involved in commissioning upgrades and new investment in treatment plants. The process for establishing new town sewerage schemes calls for stakeholder involvement to first establish the need for sewerage. Proposals to EPA for construction of schemes are expected towards the end of the process once designs are completed, and only where new treatment plants are required. Some authorities will utilise existing treatment plants hence EPA approvals for the construction are not required.

Industrial discharges into sewerage systems

Unauthorised discharges arise from either authorised trade waste customers discharging non-complying waste, or by unauthorised malicious dumping by non-trade waste customers that may occur at any point in the system. The former requires close monitoring at the source by the authorities and sanctions on trade waste customers if appropriate. Close monitoring of the latter source of inappropriate discharges is more difficult as the source is unknown to the authority.

❒ ***RESPONSE*** *provided by Chairman, Environment Protection Authority*

Compliance with EPA licences

Most discharges to land utilise lagoon treatment systems. The effluent quality produced by lagoons is influenced by algal productivity, which can be highly variable and does not necessarily mean a reduced performance of the wastewater treatment system. In most cases algae can be safely irrigated onto land. EPA is reviewing its licensing requirements for lagoon systems where the effluent is irrigated onto land to more accurately reflect this situation.

For treatment plants that require substantive capital upgrades to achieve full licence compliance, EPA has agreed that these works should be part of the overall upgrades being implemented to achieve compliance with Policy by 2001. As most of these works will only be completed over the next 2 years, no improvement in licence compliance was found in the current audit. For other plants, water authorities have responded to EPA initiatives, resulting in a doubling in the number of compliant treatment plants over the past 12 months.

❒ ***RESPONSE*** *provided by Chairman, Environment Protection Authority - continued*

A number of water authorities have a large number of treatment plants requiring upgrades to achieve Policy compliance and have indicated that total completion of works by 2001 will be very difficult. EPA has provided advice on prioritisation of works to ensure that upgrades of poorly performing treatment plants are not delayed beyond 2001.

Upgrading of sewerage systems

EPA advised the Auditor-General's Office of a number of sewerage schemes either in progress or completed, with applications for EPA works approval expected shortly for those schemes needing to build treatment works. The time required to consult with the community and to ensure the best solution to sewerage management is being implemented means that works for most of these new town schemes will only commence towards the end of the program rather than the start.

While some residents in some towns have voiced concern over the cost of service provision, there are many towns which have strongly endorsed this initiative and welcomed the opportunity to resolve long-standing amenity and pollution concerns resulting from inadequate septic tank systems.

NON-METROPOLITAN URBAN WATER AUTHORITIES - BENCHMARKING OF PERFORMANCE

3.5.75 The Auditor-General's May 1998 *Report on Ministerial Portfolios* commented on the Government's reform program for the non-metropolitan urban water sector. A key thrust of this reform program, which commenced in 1994, was for the authorities to develop a strong focus on their core business functions of urban water and wastewater services, and on the adoption of commercial management principles. The reform process was also designed to introduce competition in order to drive efficiencies and empower customers to make choices about the services they require.

3.5.76 Non-metropolitan urban water authorities operate within the framework established by the *Water Act* 1989, which among other things requires them to:

- promote the orderly, equitable and efficient use of water resources;
- ensure that water resources are conserved and properly managed for sustainable use for the benefit of present and future Victorians; and
- foster the provision of responsible and efficient water services suited to the various needs and various customers.

3.5.77 While these authorities do not operate within a regulatory framework similar to that of the 3 metropolitan retail water suppliers, the Water Agencies Branch within the Department of Natural Resources and Environment has responsibility for monitoring the interface between the Minister and the water industry, including compliance with legislation, regulation, policy and general accountability. The major objective of the Branch is to provide advice and support to the Minister and the Department on key policy issues and matters requiring co-ordination and integration.

Departmental monitoring of performance

3.5.78 In accordance with a Ministerial Direction issued under the authority of the *Financial Management Act* 1994, non-metropolitan urban water authorities are required to prepare, as part of their annual Report of Operations, a performance report detailing their:

- performance against 6 financial, one environmental and 5 service delivery performance indicators;
- planned target for each indicator specified in their business plan; and
- explanations of significant variances between planned targets and actual results.

3.5.79 Authorities are required to provide their annual Report on Operations to the Minister, to enable the tabling of the Report in Parliament by the end of October, following the end of the financial year.

3.5.80 The audit review of the monitoring processes adopted by the Department of non-metropolitan urban water authority operations disclosed that:

- The current reporting timeframe does not allow for the Department to receive information on the performance of authorities with sufficient time to enable the development of related overview information to be incorporated in its own annual report. This situation resulted in the Department recording target rather than actual information regarding the performance of water authorities, such as the overall projected level of compliance of authorities with water quality guidelines, in its annual report;
- The accuracy of the performance information provided by each Authority is not verified by the Department, or agreed to that published in the annual reports of each authority;
- The performance indicators developed by the Department for authorities are not descriptive enough in all cases to ensure that they are consistently applied. An example of this is the "properties interrupted ratio", where the information requested on interruptions relating to the supply of water is not clearly defined and as a result information on disruptions can include either planned or unplanned interruptions; and
- Although all authorities included a performance report in the Report of Operations section of their annual report, only 9 out of 15 authorities fully reported on the performance indicators as required by the Ministerial Directions.

3.5.81 **The Department needs to strengthen its non-metropolitan urban water authority monitoring function to ensure that all authorities meet the statutory reporting obligations in relation to performance information, to ensure the objectives of the reform program are achieved.**

Performance of authorities

3.5.82 In order to review the performance of individual authorities, audit requested from the Department details of each authority's reported performance against the 12 indicators outlined in the Ministerial Directions, under the *Financial Management Act* 1994, for the 1996-97 and 1997-98 financial years.

3.5.83 To assist in ensuring the integrity of this information, audit then sent the information to authorities for confirmation. Authorities were also requested to provide explanations for variances in actual performance between the 1996-97 and 1997-98 financial years, and variances between actual and projected results for the 1997-98 financial year.

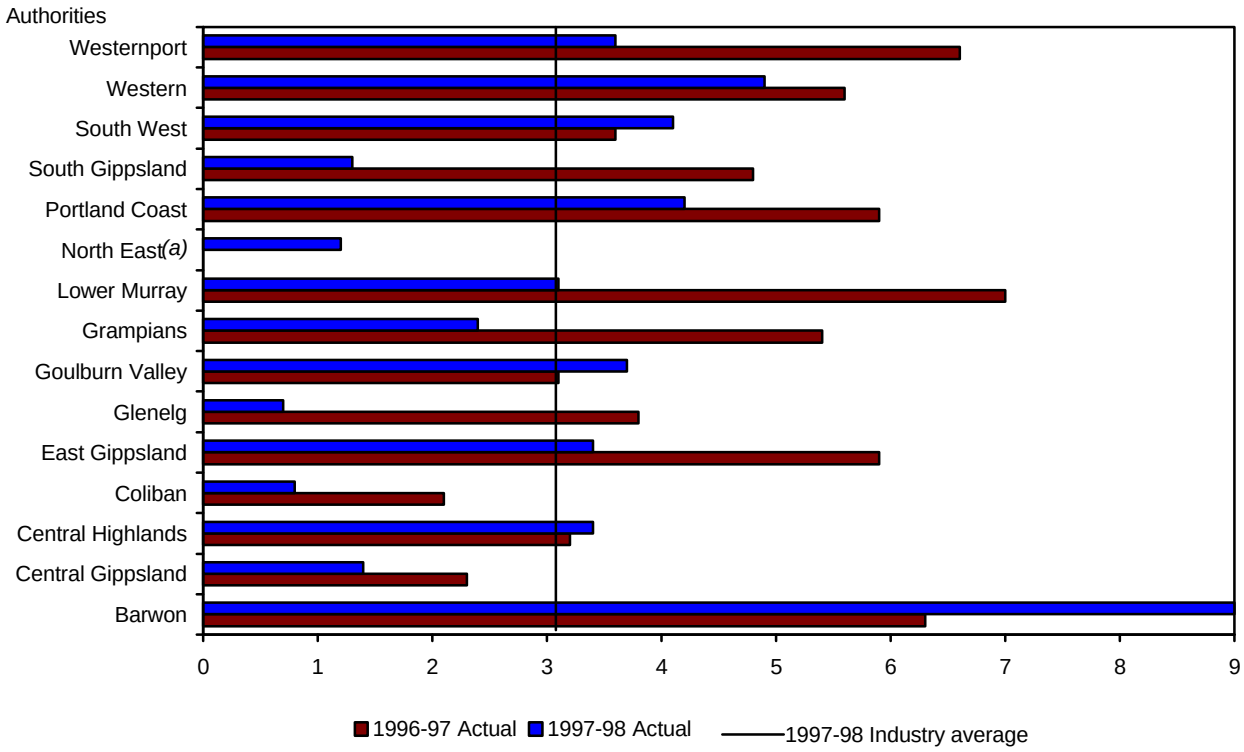
3.5.84 Below are the results of the audit analysis of authorities performance, with reference to some of the indicators used by the industry.

Financial performance

Return on assets

3.5.85 As indicated earlier in this Report, an objective of the Government's reform process was to establish the authorities as businesses, which would generate reasonable returns on the significant investment of public moneys in the industry. Chart 3.5H illustrates that the returns generated on assets employed by authorities during the 1997-98 financial year ranged from 0.7 per cent to 9 per cent, with the industry as a whole generating a return on assets of around 3 per cent. As the average return on assets was 4.7 per cent in the 1996-97 financial year, the profitability of the industry as a whole has declined in the 1997-98 financial year when compared with the previous financial year.

CHART 3.5H
RETURN ON ASSETS, NON-METROPOLITAN URBAN WATER AUTHORITIES
(per cent)



(a) Comparatives for 1996-97 are not provided for the North East Region Water Authority as it was formed on 1 July 1997 from the amalgamation of Kiewa-Murray and Ovens Region Water Authorities.

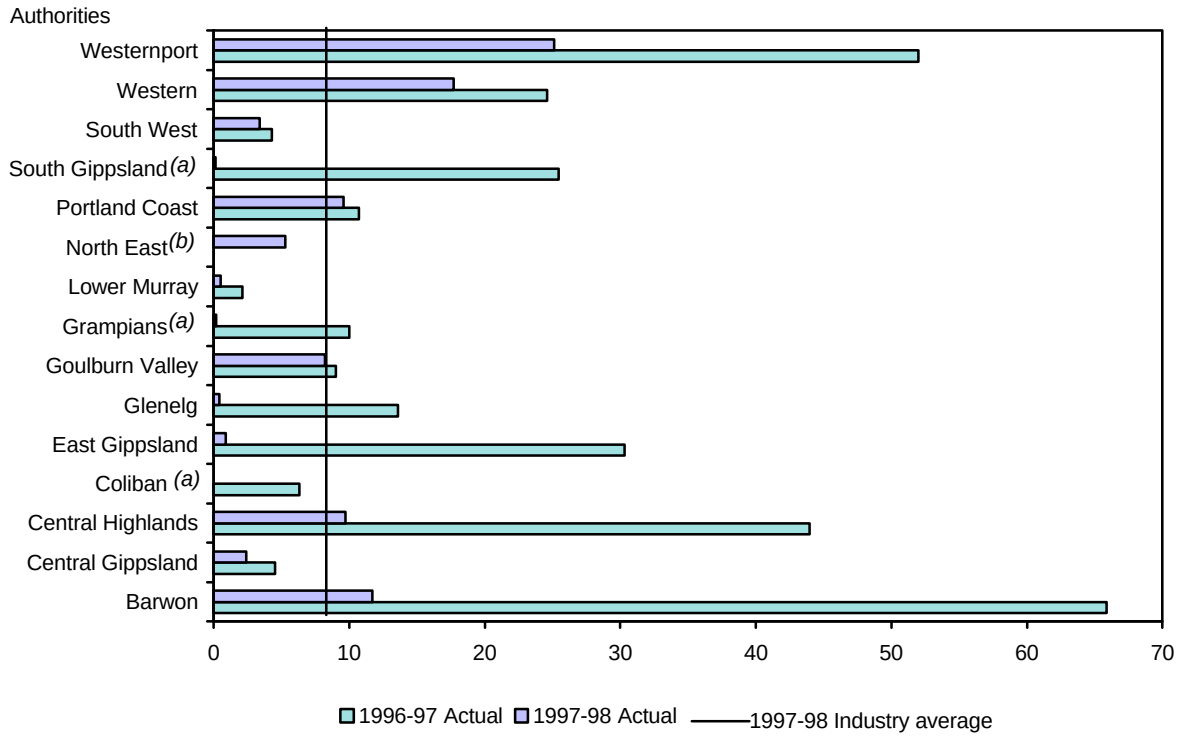
3.5.86 **The low returns generated by authorities in the 1997-98 financial year can be largely attributed to the low charges levied by these authorities for water and sewerage services following the implementation of the Government's $410 million financial assistance package for the sector in December 1997, which was intended to achieve a 18 per cent reduction in charges.**

Debt-to-equity ratio

3.5.87 The debt-to-equity ratios of the authorities, which indicates the extent to which authorities are reliant on debt financing, reflect the very low level of external debt within the sector. In particular, **the average debt-to-equity ratio for the sector as at 30 June 1998 was 6 per cent, which was considerably less than for similar businesses, such as the metropolitan water sector, where the average debt-to-equity ratio was 40 per cent.**

3.5.88 Chart 3.5I shows the debt-to-equity ratios of the individual authorities as at 30 June 1997 and 30 June 1998.

CHART 3.5I
DEBT-TO-EQUITY RATIOS, NON-METROPOLITAN URBAN WATER AUTHORITIES
(per cent)



(a) Authorities have less than $300 000 in debt.

(b) Comparatives for 1996-97 are not provided for the North East Region Water Authority as it was formed on 1 July 1997 from the amalgamation of Kiewa-Murray and Ovens Region Water Authorities.

3.5.89 **The chart illustrates that the debt-to-equity ratios for most authorities fell significantly during the 1997-98 financial year, which is largely the result of authorities reducing their debt levels following additional funding provided under the Government's reform package.**

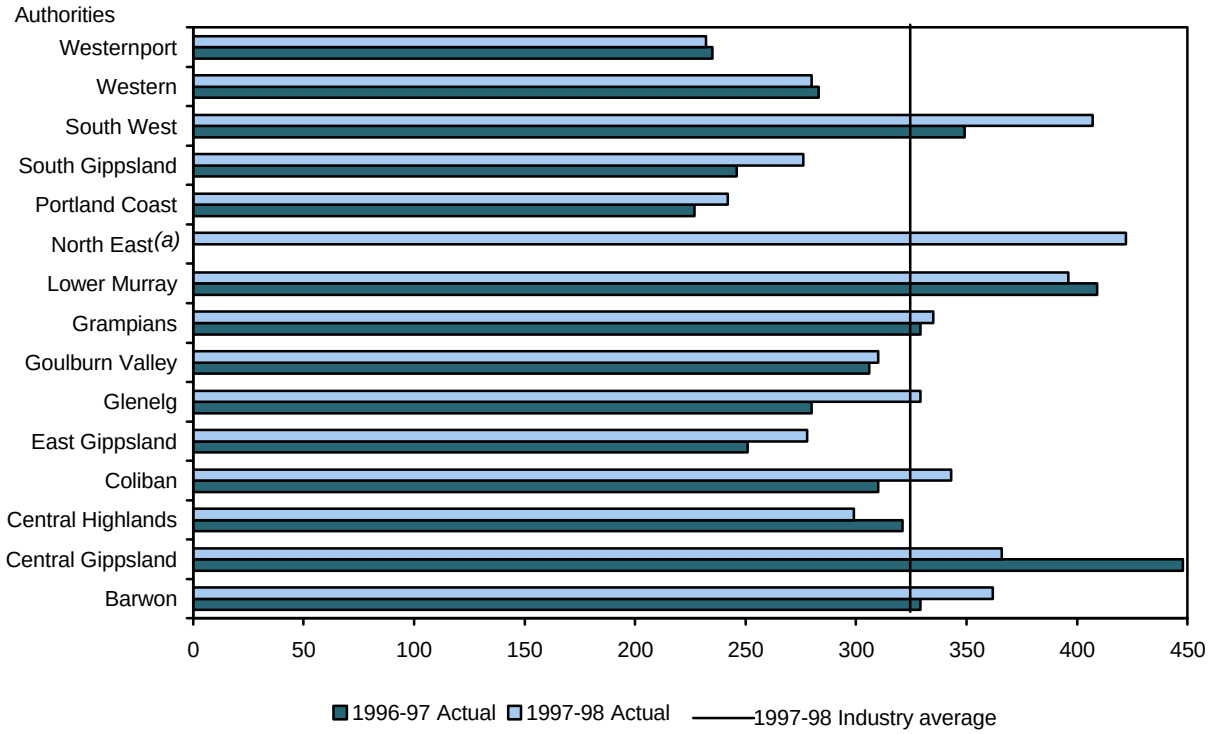
3.5.90 The overall level of debt within the sector is likely to increase in the near future as authorities undertake infrastructure improvements outlined in their Memoranda of Understanding with the Government. However, the Department advised that debt within the sector will not return to its pre-1997-98 levels due to the increased use of private sector finance arrangements (BOO and BOOT schemes) associated with the construction and operation of water infrastructure assets.

Operating efficiency

Operating maintenance and administrative costs

3.5.91 An important financial indicator for authorities is the cost of operations, maintenance and administration per megalitre of water supplied. Chart 3.5J outlines these costs per megalitre of water sold for the retail component of each authority's business. The costs associated with the bulk water function have been excluded due to authorities having limited control over these costs.

CHART 3.5J
OPERATIONS MAINTENANCE AND ADMINISTRATION COSTS, RETAIL WATER FUNCTION
(dollars per megalitre of water sold)



(a) Comparatives for 1996-97 are not provided for the North East Region Water Authority as it was formed on 1 July 1997 from the amalgamation of Kiewa-Murray and Ovens Region Water Authorities.

3.5.92 The chart shows that operations, maintenance and administration costs associated with authorities' retail water functions range from $232 to $422 per megalitre of water sold, with an average industry cost of $325. The average industry costs have increased by $72 per megalitre of water sold (26 per cent) compared with the previous year and are likely to increase further as authorities build and upgrade water and wastewater treatment facilities.

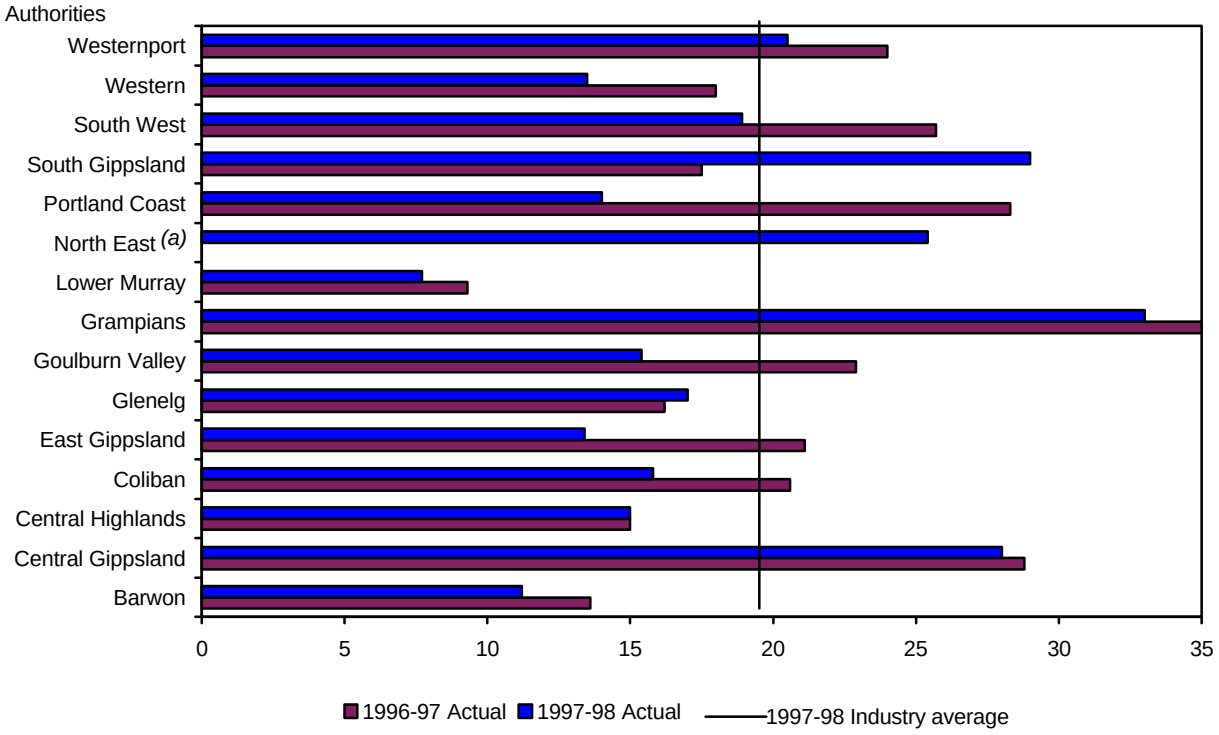
3.5.93 Audit recognises that due to differences between authorities, it may not always be appropriate to compare the performance of individual authorities against the industry average. **However, with 4 of the authorities experiencing costs significantly above average, there may be scope for cost savings by these organisations.**

Unaccounted water

3.5.94 Unaccounted water represents the difference between the volume of water released from the storage facilities of authorities and the metered consumption by consumers. Unaccounted water can result from inaccurate water meters, leakage from the system or authorities providing water free of charge as a community service.

3.5.95 The audit examination revealed that of the 804 000 megalitres of water taken from authority catchments during the 1997-98 financial year, around 145 000 megalitres or 18 per cent could not be accounted for by authorities. As illustrated in Chart 3.5K, the level of unaccounted water among individual authorities ranged from 7 to 35 per cent.

CHART 3.5K
UNACCOUNTED WATER, 1996-97 AND 1997-98
(per cent)



(a) Comparatives for 1996-97 are not provided for the North East Region Water Authority as it was formed on 1 July 1997 from the amalgamation of Kiewa-Murray and Ovens Region Water Authorities.

3.5.96 The chart shows that the sectors' management of unaccounted water is improving with the percentage of unaccounted water reducing from 21 per cent in the 1996-97 financial year to 18.5 in the 1997-98 financial year.

3.5.97 **In order to effectively manage their water resources, water authorities need to identify the causes of unaccounted water and develop appropriate strategies to address the problems, where necessary.** The Department should also review the ongoing management of unaccounted water by authorities.

Customer service

Service disruption (water)

3.5.98 Interruptions to water supplies are caused by a number of factors including climatic changes, underlying geology, rainfall and the age and condition of infrastructure assets.

3.5.99 Audit identified that during 1997-98 financial year, water services provided by authorities experienced 220 interruptions per 1 000 properties, with the average duration of interruptions lasting 1.6 hours, which compares favourably with the standard customer service objective for water businesses generally which is to maintain the disruption duration to within 5 hours.

3.5.100 The audit review also disclosed that, in respect of 90 per cent of disruptions, services were resumed to customers within 5 hours, and that in 6 of the authorities services were resumed within 5 hours in all cases.

Service disruption (wastewater)

3.5.101 In relation to disruptions in wastewater services, the audit review disclosed that in respect of 98 per cent of disruptions, services were resumed to customers within 5 hours and that, in 6 of the authorities services were resumed within 5 hours in all cases.

3.5.102 As with water service disruptions, based on the information provided to audit, the 1996-97 performance of authorities in meeting the industry standard is considered to be good, with their level of performance decreasing marginally in the 1997-98 financial year.

Water quality

3.5.103 The water quality performance indicator measures the percentage of the population in receipt of water which meets the microbiological standard for water quality, outlined in the World Health Organisation 1984 guidelines. The sectors' performance against this indicator has improved with 60 per cent of country Victorians receiving water which met the standard outlined in the guidelines in the 1997-98 financial year, compared with 58 per cent in the 1996-97 financial year. Detailed analysis of water quality is contained in a separate section of this Report.

Environmental performance

3.5.104 The environmental performance indicator measures the compliance of wastewater treatment plants, operated by authorities, with their Environment Protection Authority (EPA) licenses. The sectors' average compliance with the wastewater discharge standards, specified in their treatment plant EPA licenses, has remained relatively stable over the last 3 years at around 87 per cent. Detailed analysis of wastewater discharge compliance with EPA licenses is also contained in a separate section of this Report.

Overall performance

3.5.105 **Following the provision of $410 million by the State Government in December 1997, authorities have steadily set about upgrading their infrastructure in order to significantly improve the quality of water they provide to the community and reduce the negative impact of wastewater discharges on the environment. At the same time, customers have benefited from a substantial reduction in charges.**

3.5.106 **The audit review identified that the performance of the non-metropolitan water authorities, with reference to return on assets and operational efficiency indicators, deteriorated during the 1997-98 financial year, with the quality of service marginally improved over this period. It is considered that the Government decision to reduce service charges and upgrade infrastructure have been a major determinant of these outcomes.**

❒ ***RESPONSE*** *provided by Secretary, Department of Natural Resources and Environment*

Departmental monitoring of performance

The above conclusions do not accurately reflect the scope of either the performance monitoring or reporting requirements for non-metropolitan water authorities.

Water agencies' staff monitor the performance of water authorities against corporate plan objectives quarterly and annually. The monitoring process results in briefings to the Minister on issues of concern. The published Annual Report information is verified and explanations sought for apparent differences.

The performance of the water industry is publicly reported on in both "WSAA Facts" (for the major urban authorities in Australia), published annually by the Water Services Association of Australia (WSAA), and in the "Urban Water Review" also published annually by the Victorian Water Industry Association (VicWater).

The definitions of performance indicators are the same as those adopted by WSAA, VicWater and COAG in performance monitoring; the definition of properties interrupted has been agreed with the other parties to include only unplanned interruptions.

During a period of further amalgamation in 1997-98 a number of authorities were unable to make meaningful comparisons of actual performance to planned performance as the original plans were developed for the former authorities. Only 2 authorities have significant areas of non-compliance.

Financial performance - Return on assets

The Government's policy is to deliver improved water and sewerage services at the lowest cost to consumers consistent with the financial viability of non-metropolitan urban water authorities. It is misleading, however, to refer to the water charges as "low". Water charges outside Melbourne vary significantly depending on the location and characteristics of the supply system. Charges are set to recover costs, including operations, maintenance administration, asset replacement and, where appropriate, augmentation.

❒ ***RESPONSE*** *provided by Secretary, Department of Natural Resources and Environment - continued*

Financial performance - operating efficiency

As partly acknowledged by audit, cost comparisons of this kind are not useful without adequate explanation of the different nature and cost structure in which each authority operates. Some of the authorities having lower costs supply water that requires minimum treatment and reticulation (e.g. groundwater). Others supply water that requires significant treatment and investment in reticulation systems and these authorities are therefore subject to higher operational costs.

The increase in costs also relates to the overall increase in water demand, due to the drought conditions experienced in 1997-98, which tends to increase operating costs as more expensive water sources need to be brought on line.

Significant operational efficiencies have been achieved as a result of past amalgamations. However, as water and wastewater treatment plants come on line, operating costs per volume of water sold increase. Future savings for each authority will be determined by the individual cost structure in each water quality and wastewater zone.

Financial performance - Unaccounted water

The analysis does not relate the observed results for NMU authorities to an industry average, or desired level, or to differences in the physical environment within which different authorities must operate, or the geographic extent of their delivery systems. Much of the unaccounted for water is to provide water for community benefits (e.g. firefighting) and the flushing and scouring of pipes. Nevertheless, the Department has worked with the industry towards cost-efficient investment in measures to reduce the amount of unaccounted water.

Overall conclusion

The Department does not accept that a reduced rate of return and increase in operating expenditure represents a deterioration in performance. It is in fact a direct consequence of an explicit policy decision by Government to implement further major improvements in the quality of water and sewerage services to country Victoria and to reduce charges. The Government injected $410 million in January 1998 to assist in achieving these outcomes.

Capital investment in water and wastewater services carries with it a requirement for increased expenditure on the associated operating costs. This point was recognised in the Auditor-General's 1998 Report on water sector operating efficiency targets.

Customer service standards have improved during the period of accelerated capital expenditure.

RESTORATION OF MINING SITES

3.5.107 Among the key responsibilities of the Department of Natural Resources and Environment are the protection and enhancement of Victoria's natural resources and attractions, and the improvement of the economic competitiveness and sustainable development of the State's natural resource-based industries.

3.5.108 The Minerals and Petroleum Regulation Branch of the Department administers the *Mineral Resources Development Act* 1990 and the *Extractive Industries Development Act* 1995 and has specific responsibility for:

- assessment, granting and ongoing administration of all mining licences, leases, authorities and permits;
- safety and environmental regulation of all sites operating under these Acts.
- monitoring of compliance by individual mining licences with legislative requirements;
- oversight of the rehabilitation of mining sites; and
- setting and management of rehabilitation bonds.

Rehabilitation works

3.5.109 In facilitating the rehabilitation of mining sites, the Department endeavours, as far as possible, to ensure the restoration of each site to its condition prior to the mining or excavation taking place. In this regard, the Department requires the development of a concept plan by each licensee which identifies the expected end uses of the site, and the site's general characteristics at the completion of rehabilitation works. A progressive plan, detailing how the proposed rehabilitation works are to be undertaken and the sequence and timing of these works, is also required to be developed. In particular, the Department requires these plans to take into account:

- any special characteristics of the land;
- the surrounding environment;
- the need to stabilise the land;
- the desirability or otherwise of returning agricultural land to a state that closely resembles its condition prior to the mining licence or work authority; and
- the need to protect or conserve native vegetation and protected flora and fauna.

Poor monitoring of rehabilitation works

3.5.110 In accordance with current legislative requirements, prior to work commencing on any site, holders of a mining licence, exploration licence or work authority are required to:

- submit to the Department an approved work plan, including a rehabilitation plan;
- lodge with the Department a bond equivalent in value to the estimated cost required to rehabilitate the mined site; and
- obtain all the necessary consents and complete compensation agreements with the relevant land owners or occupiers.

Rehabilitation activites at former Moliagul mining site.

3.5.111 The Department conducts risk-based inspections to ensure work performed at the site, including obligatory rehabilitation, has been conducted in accordance with approved work plans and complies with the conditions of the licence.

3.5.112 An audit review of 22 expired licenses at 28 April 1999 disclosed that:

- the last review of 15 (68 per cent) of these licences was undertaken on or before 1 January 1998; and
- inspections of 8 licenses were not undertaken as scheduled by the Department and scheduled inspections for 2 of the 8 licences were in excess of 5 years overdue.

3.5.113 **As a result of delays in undertaking inspections, the Department cannot be assured that mining operators have rehabilitated sites in accordance with approved work plans and within a reasonable timeframe. Delays in inspection of sites also result in corresponding delays in the restoration of mining sites where further rehabilitation of the land is considered necessary.**

3.5.114 **There is a need for the Department to review its rehabilitation inspection process in order to ensure that site inspections are conducted in a timely manner.**

Unrehabititated sites

3.5.115 At the time that the *Mineral Resources Development Act* 1990 was enacted, the Department became responsible for a number of old mined or excavated sites where bonds held by the Department, if any, were insufficient to restore the sites.

3.5.116 Audit was informed that, at that time the Department's Environmental Operations Unit became responsible for rehabilitation of all unexpired mining and exploration licenses and for sites where bonds were held by the Department. Responsibility for the hundreds of remaining unrehabilitated sites has been assigned to the Department's regional offices.

3.5.117 The audit review disclosed that rehabilitation sites in some regions had been identified, restoration works prioritised and rehabilitation on a selected number of sites was progressing, while in other regions many unrehabilitated sites had not been identified.

3.5.118 **Given the potential safety risk to the community of these unrehabilitated sites, it is important that the Department identify and complete their restoration as soon as possible.**

Adequacy of rehabilitation

3.5.119 Audit held discussions with the Victorian National Parks Association (VNPA) which is a non-government and a not-for-profit organisation which promotes interest in and care of natural areas, and other local community groups, in order to seek their views on the adequacy of the Department's management of mining site rehabilitation. Audit was advised that the success or otherwise of rehabilitation was difficult to determine as full restoration of sites only occurs a number of years following the completion of the rehabilitation works.

3.5.120 The VNPA indicated that, in its opinion, rehabilitation was generally ineffective given that rare and threatened species of plants and animals which previously habitated mining sites may not recolonise these sites for many decades, if at all. In addition, VNPA and other local community groups consulted by audit considered that reconstituted flora and fauna were generally a poor substitute for the original flora and fauna, and that it may take centuries of natural rehabilitation, particularly where mining has occurred within box-ironbark forest areas, for the site to be fully restored.

3.5.121 The Department recently reviewed the impact of mining undertaken during the period 1976 to 1996 on public land in the "Box-Ironbark Ecosystem", which incorporates many forests and woodlands in northern and central Victoria. The Box-Ironbark Ecosystem also includes a unique assortment of birds, mammals, reptiles and other species. The review aimed to:

- assess the extent of the Box-Ironbark Ecosystem area affected by different types of mining activity;
- determine the impact of each type of mining activity; and
- measure the success of rehabilitation.

3.5.122 **Although the review was not completed at the time of preparation of this Report, a draft report issued in March 1998 indicated that there was substantial scope for improvement in the rehabilitation of mined land.** In particular, the review concluded that:

> *"... in the past rehabilitation has largely been undertaken and that, with the exception of small areas that are highly disturbed or unrecoverable, indigenous vegetation has generally been re-established in accordance with the rehabilitation standards that have been applied by the Government. However, the high average level of weed infestation and low average species diversity indicates that much of the rehabilitation would not achieve the conservation objectives of the Flora and Fauna Guarantee (Mineral Resources Development) Order 1994. The Order's objectives reflect the principles of ecological sustainability and should broadly be regarded as the benchmark for future rehabilitation. Accordingly, rehabilitation standards and methods need to be reviewed and improved in order to increase species diversity, prevent the ingress of weeds and ensure that ecological vegetation classes are correctly restored".*

3.5.123 The departmental draft report recommended that:

- a far stronger emphasis be placed on the quality of native vegetation in the rehabilitation of mine sites, in particular improving species diversity and reducing weeds;
- ongoing research be conducted into rehabilitation and weed control methods; and
- more formalised pre-mining planning be undertaken by the Department.

3.5.124 Audit supports the above draft recommendations of the Box-Ironbark Ecosystem review. The final findings and recommendations of this review are expected to be available by late 1999.

Rehabilitation bonds

3.5.125 Mining licensees are required to provide bonds to the Department with a value equivalent to the estimated costs of rehabilitating the respective sites. Where the Department is not satisfied that a mined or excavated site has been appropriately rehabilitated within a reasonable timeframe, it has the ability to access the licensees' rehabilitation bond moneys and to apply these funds towards site rehabilitation.

3.5.126 The extent of rehabilitation works required to restore each mining site and their estimated cost are determined by departmental officers. In relation to the majority of exploration licences, where work is primarily of a non-intrusive nature, a standard rehabilitation bond of $5 000 is established. Alternatively, where more extensive rehabilitation is required, the Department has specific guidelines for calculating the value of these bonds.

3.5.127 In the event that bonds are insufficient to cover the costs of rehabilitation, the Department may require the licensee to meet the additional costs or choose to fund the cost of these works from its operating budget.

3.5.128 **At 16 April 1999, the Department held rehabilitation bonds with a total value of $73.8 million in respect of 1 407 mining and extractive licences.**

Adequacy of rehabilitation bonds

3.5.129 The audit review found that, in determining the value of rehabilitation bonds and in addressing core rehabilitation issues, the guidelines and checklists developed by the Department were consistently applied.

3.5.130 During the past 3 years, the Department had "called-in" 22 bonds with a total value of $719 000 to complete required rehabilitation works. In respect of 7 of these bonds, the estimated costs of rehabilitation works exceeded, or were likely to exceed, the amount of the bonds received. In particular:

- in 4 of the cases, the cost of the completed rehabilitation works exceeded the value of bonds held by $18 800;
- in 2 of the cases, the estimated cost of rehabilitation is likely to exceed the value of bonds held for these sites by $125 390; and
- in the remaining case, the Department is yet to finalise the estimated cost of rehabilitation, however, initial departmental estimates indicate that expenditure is likely to exceed the bond held.

3.5.131 **During the 1997-98 and 1998-99 financial years, $148 000 of the Department's operating budget was allocated to meet the costs of rehabilitating unrestored sites.**

3.5.132 Audit was advised that while there are provisions within both the *Mineral Resources Development Act* 1990 and the *Extractive Industries Development Act* 1995 to recover costs incurred by the Department to rehabilitate land where bond moneys have been inadequate, these legislative provisions have not been utilised. Further discussions with departmental staff indicated that the legislative procedures for debt recovery are largely ineffective as the cost of court proceedings to recover debts would in most instances outweigh the moneys recovered by the Department from such actions.

3.5.133 **The Department should review all cases where the costs of restoration works have exceeded or are likely to exceed the value of bonds held in order to:**

- **ascertain the cause of the shortfall;**
- **identifying improvements to the process of calculating rehabilitation costs; and**
- **increase bond amounts, where appropriate.**

Bond reviews

3.5.134 In order to ensure that rehabilitation bonds are maintained at an appropriate level, throughout the term of the mining activities, the Department has developed a process of regular bond reviews. The review process is risk focused, with the frequency of reviews based on an assessment undertaken by environmental officers within the Department of individual sites and the activities conducted on the sites. Bond reviews are generally conducted at intervals of every 2 to 6 years, with higher risk sites generally reviewed every 2 years and low risk sites every 6 years.

3.5.135 The audit review of the Department's bond review process disclosed that:

- Formal policies, procedures and guidelines had not been developed to assist officers in assessing and documenting risks associated with each site. The factors currently considered by departmental staff when assessing risks varied in accordance with the knowledge and experience of each officer; and
- **Bond reviews were outstanding for 206 (or 15 per cent) of the 1 407 mining and extractive licences**. The Department, in recognition of the significant backlog of bond reviews, has employed temporary staff to assist in undertaking these reviews.

3.5.136 Where the rehabilitation bonds are not reviewed or reassessed in a timely manner, funds held by the Department may be insufficient to cover the cost of rehabilitating these sites, and as a result, the likelihood of the Department having to use public moneys for the restoration of mining sites increases.

3.5.137 **In order to ensure rehabilitation bonds are and continue to be sufficient to meet the costs of site rehabilitation, the Department should undertake bond reviews in a timely manner.**

3.5.138 The estimated rehabilitation costs and the value of the rehabilitation bond held for each mining site are recorded within the Department's Geological Exploration and Development Information System (GEDIS). Following each bond review, departmental staff update GEDIS to reflect any changes to site rehabilitation costs.

3.5.139 Audit analysis of the information recorded on GEDIS indicated that rehabilitation bonds had not been adjusted to reflect the most recent bond reviews. In particular, audit identified that as at 28 February 1999, **the value of bonds held by the Department in respect of 49 sites was approximately $4.2 million less than the amount estimated to rehabilitate these sites in the Department's bond review process.** Further investigation disclosed that:

- A significant portion of this difference ($3.6 million)was due to:
    - disputed bond reviews;
    - the receipt of bonds in stages in line with the progress of mining or excavating activities;
    - mining and excavation activities receiving approvals but work had not commenced; and

- negotiations regarding the sale of a licence were in progress with the Department requesting an adjustment to the bond before the transfer is approved.

- approximately $74 000 of the $4.2 million related to bond adjustments required on 5 sites resulting from bond reviews undertaken in excess of 2 years previously;
- the value of bonds held by the Department exceeded the expected restoration costs in 19 instances; and
- works had commenced at one site without an appropriate bond having been lodged.

3.5.140 **To ensure sufficient funds are available to rehabilitate all mining sites, the Department should take immediate action to investigate the $4.2 million difference between bonds held and the amount estimated to rehabilitate these sites and collect additional bond moneys identified in its bond review process.**

Return of rehabilitation bonds to licensees

3.5.141 The Department has a legislative responsibility to return bonds to licensees as soon as practicable following the completion of the required rehabilitation, and to return all bond moneys not expended within a 6 year period following the expiration of the licence, regardless of whether the rehabilitation has been completed.

3.5.142 While the Department was unable to provide audit with details of bonds returned to licensees, audit was able to obtain information regarding the number of bonds currently held in relation to expired licences, the value of bonds held in respect of these licenses and the period of time since the expiry of these licenses. This information is outlined in Table 3.5L.

TABLE 3.5L
NUMBER OF BONDS HELD, VALUE OF BONDS AND PERIOD SINCE LICENSE EXPIRED AT 16 APRIL 1999

Period since expiry of licence	*Bonds held*	
(years)	*(No.)*	*$'000*
0 to 3	112	848
4 to 6	72	264
over 6	31	100
Total	**215**	**1 212**

3.5.143 **As indicated in the table, at the time of preparation of this Report the Department held 215 bonds relating to expired licenses and that, in respect of 31 of these licences, bonds with a total value of $100 000 had not been returned to licensees in accordance with legislative requirements. The Department should, as a matter of priority, return this amount to bond holders whose licenses expired more than 6 years ago.**

3.5.144 **As indicated earlier in this Report it is important that the Department undertake regular site inspections of expired licenses and complete rehabilitation works as soon as possible. In order to ensure rehabilitation is undertaken on a timely basis, consideration should also be given to requiring licencees to substantially complete rehabilitation works within the term of the licence.**

Difficulties in accessing bond moneys

3.5.145 Prior to July 1995, licencees were allowed to invest bond moneys in term deposits in their own name following confirmation in writing from the relevant institution holding the funds that it would not release the deposit without the permission of the Department.

3.5.146 Audit testing identified 4 instances where restoration work had not been appropriately completed by the licensee, however, the Department was unable to access the bond moneys which were held in term deposits. In those instances, the Department was advised by the relevant financial institution that licensees had been allowed to withdraw term deposits without the consent of the Department as there was no legal basis to withhold moneys from the holder of a term deposit account.

3.5.147 In July 1995, following an independent review, the Department resolved to:

- replace term deposits with bank guarantees for all existing bonds; and
- obtain future bonds in the form of a bank guarantee issued by an appropriate and recognised bank.

3.5.148 **However, as at April 1999, departmental records show that bond moneys of $544 000 were still held by the Department in the form of term deposits. In the event that these sites are not appropriately restored by the licensee, the Department may not be able to access the moneys held in term deposits, or to recover the costs from licensees, which again may result in the application of public moneys to meet these costs.**

3.5.149 **In order to minimise the costs to the public of restoring mining sites, the Department should negotiate with licensees to convert any term deposits to bank guarantees.**

❒ ***RESPONSE*** *provided by Secretary, Department of Natural Resources and Environment*

Monitoring of rehabilitation works

The Department is upgrading its inspection scheduling database. Further development of the system and training of staff is in progress to ensure that inspections are conducted in a timely manner.

Unrehabilitated sites

The Report does not distinguish between contemporary or recent mine sites and those where mining occurred at some time in the more distant past. The Department and its predecessors have had continuing responsibility for rehabilitation of current mine sites under both the current Mineral Resources Development Act and the previous Mines Act. However, there are a large number of sites on Crown land where mining occurred historically. In most cases these sites were mined many decades ago.

The Department regards that identification of high risk sites as a priority. Decisions on commitment to remediation works are based on an assessment of the specific level of risk associated with individual sites.

Adequacy of rehabilitation

The Department agrees that the success of mine site rehabilitation can take many years or decades to determine. The majority of examples available today relate to past practices when the legislative framework, and community expectations, were different. The Department has sponsored an analysis of the impact of past mining as an input into the deliberations of the Environment Conservation Council review of the Box Ironbark Ecosystem.

Adequacy of rehabilitation bonds

In a small number of cases bonds have been found to be insufficient for rehabilitation. In the significant cases to date it has been found that all were bonds set prior to the introduction of current procedures for bond setting and review. It is often commercially and legally impossible to adjust rehabilitation bonds on sites which have been under-bonded due to past legislation and practices. The Department has recently reviewed bond setting procedures to minimise the risk of this continuing to occur.

Bond reviews

The Report correctly states that a number of sites are overdue to bond review and that the Department has allocated resources to address the problem. In addition, it is stated that 49 sites have total shortfall between recommended and actual bond of $4.2 million. Most of this amount [$3.6 million] is accounted for by the various circumstances set out in the Report. However, these factors are normal timing issues associated with the administration of rehabilitation bonds and will be resolved accordingly. For those situations not covered by the circumstances outlined in the Report the Department is reviewing the situation to resolve any incomplete bond reviews.

❒ ***RESPONSE*** *provided by Secretary, Department of Natural Resources and Environment - continued*

Return of rehabilitation bonds

The Department currently holds a small number of bonds where rehabilitation has not been completed but more than 6 years have elapsed since expiry of the title. Some are held with the agreement of the former licensee. It is unclear whether the relevant section of the Act requires immediate unconditional return of the bond after 6 years or not. This issue will be clarified and bonds returned immediately if audit's interpretation of the legislation is correct.

Difficulties in accessing bond moneys

It is Department policy to accept only bank guarantees for bonds. It is agreed that bonds currently held as term deposits should be replaced by bank guarantees. The Department has a program to identify all such bonds and to advise licensees that this change is required. In most cases the amounts are small and it is proposed to change the form of bond at the time of next bond review. However, for sites with large bonds or assessed as having high risks, licensees will be requested to make an immediate change. The Department agrees with the recommendations and will continue this work.

SCHEDULE A
STATUS OF MATTERS RAISED IN PREVIOUS REPORTS

Report	*Subject*	*Status at date of preparation of this Report*
	MATTERS RESOLVED OR ACTION COMMENCED	
DEPARTMENT OF NATURAL RESOURCES AND ENVIRONMENT		
Second Reports, 1985-86 and 1986-87. Ministerial Portfolios, May 1989, pp. 45-6. May 1990, pp. 68-70.	Deficiencies in the debtors and revenue collection system, including long overdue debtors balances.	Although the Department debtors balance has decreased from $23.1 million in 1997 to $22.5 million in 1998, audit considers that scope still exists to further improve its management of debtors. The Department is reviewing its revenue collection and debt management, with the review expected to be completed by June 1999.
Ministerial Portfolios, May 1997, pp. 158-62.	There is a need for the Department to review the current reporting framework relating to committees of management and trustees, to provide a proper accountability process. The receipt and review of limited financial information once every 3 years, together with the absence of an appropriate departmental program to inspect Crown land reserves, did not ensure that the Department became aware on a timely basis of potential problems arising in committees of management.	The Department is investigating the feasibility of devolving all community-use Crown land of local or regional significance to municipal councils or other appropriate bodies. Financial accountability and reporting, public risk liability and the issue and administration of leases and licences to specific users may be devolved if this initiative proceeds. The Department will also establish an appropriate hierarchy of minimum accountability requirements for the 4 000 delegated management reserves. Reserves of Statewide significance will be identified and retained under the control of the Department.
Ministerial Portfolios, May 1997, p. 156.	In relation to a number of forest management areas, the Department is incurring costs to allow operators to remove native trees and wood products, with limited financial benefits accruing back to the State.	The Department assesses viability of its commercial forests on a State-wide basis not individually for each forest management area. Current reforms by way of the establishment of Forestry Victoria, a service agency in the Department, will clarify the commercial operations of the forest business and provide a clearer basis for the commercial performance of the business.

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

Report	*Subject*	*Status at date of preparation of this Report*
	MATTERS RESOLVED OR ACTION COMMENCED - *continued*	
MELBOURNE WATER INDUSTRY REFORM		
Ministerial Portfolios, May 1997, p. 171.	There is a prima facie case to suggest that the current levels of unaccounted water relating to the retail water companies are too high and can be economically reduced.	The retail water companies are reducing the impact of unaccounted water on their businesses through their meter replacement and leakage reduction programs, and public education on water efficiency use.
Ministerial Portfolios, May 1998, p. 175.	While the reform process envisaged the issue of licence agreements between the government and individual non-metropolitan water authorities by July 1995, and the establishment of an independent regulator, these aspects of the reform process have not been implemented.	Refer to comments under this Part of the Report.
Ministerial Portfolios, May 1998, p. 177-9.	Only 57 per cent of the population supplied by non-metropolitan water authorities received water that meet the guidelines for micro-biological quality. Of particular concern, was that one-third of water that was treated did not meet the guidelines.	Refer to comments under this Part of the Report.
Ministerial Portfolios, May 1998 pp. 179-81	Only 13 per cent of wastewater treatment plants operated by non-metropolitan water authorities fully met the Environment Protection Authority Standards outlined in their licence agreements for the discharge of treated wastewater into waterways.	Refer to comments under this Part of the Report.
Ministerial Portfolios, May 1996, p. 221.	In order to strengthen the Regulator-General's control over pricing policy, the Government should consider the introduction of a licence, monitored by the Regulator-General, to cover the provision of the Melbourne Water Corporation's services.	The regulatory framework for water is currently being reviewed.

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

Report	*Subject*	*Status at date of preparation of this Report*
	MATTERS RESOLVED OR ACTION COMMENCED - *continued*	
VICTORIAN DAIRY INDUSTRY AUTHORITY		
Ministerial Portfolios, May 1998, pp. 183-88.	The Victorian Dairy Industry Authority's share of the estimated accumulated losses in a joint venture in China to 30 June 1998 is expected to be $564 000. In addition, the Authority has written-off $530 000 of its initial investment on the venture of $730 000, expended a further $125 000 on the venture and incurred unquantified costs associated with its management. Accordingly, the joint venture has cost the Authority in excess of $1.2 million.	At the date of this Report, the Authority's share of the estimated accumulated losses in the joint venture has increased to $740 000. The Victorian Dairy Industry Authority is continuing its efforts to sell its share in the joint venture. For the year ended 30 June 1998, a qualified opinion was issued on the financial statements of the joint venture (Tianjin Vic Food Corporation Limited) due to concerns regarding the organisation future viability.
Ministerial Portfolios, May 1998, p. 190.	In February 1997, the Authority decided to terminate its agreement with Australian Milk Marketing (AMM). In response, AMM obtained an injunction from the Supreme Court. The matter was finally heard in the Supreme Court in November 1997.	The Authority lost this case and was required to pay a settlement to AMM of $450 000. The Authority has also incurred costs of approximately $380 000 in defending this case.
	NO ACTION TAKEN	
MELBOURNE WATER CORPORATION		
Second Report, 1986-87, pp. 164-5. Ministerial Portfolios, May 1990, p. 343. May 1992, p. 432.	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.	The Corporation considers that it is not viable for it to levy interest on drainage rates as water and sewerage charges appearing on the same bill would not attract interest since they are not categorised as rates. In addition, the Corporation considers that changing interest would be difficult to administer and difficult to explain why such policy was adopted.

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 Natural Resources and Environment	30 June 1998	31 Oct. *Financial Management Act* 1994, s.46.	28 Aug. 1998	31 Aug. 1998
AGRICULTURE AND RESOURCES				
Agriculture Victoria Services Pty Ltd	30 June 1998	31 Oct. *Financial Management Act* 1994, s.53A.	29 Sept. 1998	20 Oct. 1998
Australian Food Industry Science Centre	30 June 1998	31 Oct. *Financial Management Act* 1994, s.46.	17 Mar. 1999	29 Apr. 1999
Barwon Region Water Authority	30 June 1998	" "	26 Aug. 1998	22 Sept. 1998
Barwon Regional Waste Management Group	Period 16 Dec. 1997 to 30 June 1998	" "	24 Nov. 1998	10 Feb. 1999
Calder Regional Waste Management Group	Period 23 Oct. 1997 to 30 June 1998	" "	11 Dec. 1998	24 Feb. 1999
Central Gippsland Region Water Authority	30 June 1998	" "	13 Aug. 1998	2 Sept. 1998
Central Highlands Region Water Authority	30 June 1998	" "	20 Aug. 1998	31 Aug. 1998
Central Murray Regional Waste Management Group	Period 18 Dec. 1997 to 30 June 1998	" "	10 Mar. 1999	17 Mar. 1999
City West Water Ltd	30 June 1998	31 Oct. *Financial Management Act* 1994, s.53A.	22 Sept. 1998	22 Sept. 1998
Coliban Region Water Authority	30 June 1998	31 Oct. *Financial Management Act* 1994, s.46.	28 Aug. 1998	28 Aug. 1998
Corangamite Catchment Management Authority	30 June 1998	" "	20 Aug. 1998	10 Sept. 1998
Desert Fringe Regional Waste Management Group	Period 30 Sept. 1997 to 30 June 1998	" "	16 Feb. 1999	16 Feb. 1999

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		
AGRICULTURE AND RESOURCES - *continued*				
East Gippsland Management Authority	30 June 1998	31 Oct. *Financial Management Act* 1994, s.46.	31 Aug. 1998	9 Oct. 1998
East Gippsland Region Water Authority	30 June 1998	" "	7 Aug. 1998	8 Sept. 1998
Emu Industry Development Committee	30 June 1998	" "	7 Feb. 1999	19 Feb. 1999
First Mildura Irrigation Trust	30 June 1998	" "	14 Sept. 1998	28 Sept. 1998
Food Quality Service Pty Ltd	30 June 1998	" "	19 Aug. 1998	18 Sept. 1998
Food Science Australia	Period 3 Dec. 1997 to 30 June 1998	" "	24 Dec. 1998	29 Apr. 1999
Gippsland and Southern Rural Water Authority	30 June 1998	" "	8 Sept. 1998	22 Sept. 1998
Gippsland Regional Waste Management Group	Period 21 Oct. 1997 to 30 June 1998	" "	4 Jan. 1999	11 Feb. 1999
Glenelg-Hopkins Catchment Management Authority	30 June 1998	" "	30 Sept. 1998	5 Nov. 1998
Glenelg Region Water Authority	30 June 1998	" "	22 Sept. 1998	8 Oct. 1998
Goulburn-Broken Catchment Management Authority	30 June 1998	" "	11 Sept. 1998	14 Sept. 1998
Goulburn Murray Rural Water Authority	30 June 1998	" "	13 Aug. 1998	26 Aug. 1998
Goulburn Valley Region Water Authority	30 June 1998	" "	23 Sept. 1998	23 Sept. 1998
Goulburn Valley Regional Waste Management Group	Period 17 Oct. 1997 to 30 June 1998	" "	22 Jan. 1999	17 Mar. 1999
Grampians Region Water Authority	30 June 1998	" "	18 Sept. 1998	9 Oct. 1998

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				
AGRICULTURE AND RESOURCES - *continued*				
Lower Murray Region Water Authority	30 June 1998	31 Oct. *Financial Management Act* 1994, s.46.	28 Aug. 1998	21 Sept. 1998
Mallee Catchment Management Authority	30 June 1998	" "	24 July 1998	15 Sept. 1998
Marine and Freshwater Resources Institute	30 June 1998	" "	14 Oct. 1998	14 Oct. 1998
Melbourne Market Authority	30 June 1998	" "	25 Aug. 1998	15 Sept. 1998
Melbourne Water Corporation	30 June 1998	" "	21 Aug. 1998	21 Aug. 1998
Mornington Peninsula Regional Waste Management Group	Period 22 Jan. 1998 to 30 June 1998	" "	25 Mar. 1999	21 Apr. 1999
Murray Valley Citrus Marketing Board	30 June 1998	" "	30 Sept. 1998	7 Oct. 1998
Murray Valley Wine Grape Industry Development Committee	31 July 1998	" "	23 Oct. 1998	6 Nov. 1998
North Central Catchment Authority	30 June 1998	" "	24 Aug. 1998	8 Sept. 1998
North East Catchment Management Authority	30 June 1998	" "	10 Sept. 1998	30 Sept. 1998
North East Region Water Authority	30 June 1998	" "	19 Aug. 1998	3 Sept. 1998
North East Victorian Regional Waste Management Group	Period 24 Jul. 1997 to 30 June 1998	" "	2 Dec. 1998	11 Feb. 1999
Northern Victorian Fresh Tomato Industry Development Committee	30 June 1998	" "	9 Feb. 1999	10 Feb. 1999
Portland Coast Region Water Authority	30 June 1998	" "	29 Jul. 1998	11 Sept. 1998

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*				
AGRICULTURE AND RESOURCES *- continued*				
Renewable Energy Authority of Victoria	30 June 1998	31 Oct. *Financial Management Act* 1994, s.46.	23 Oct. 1998	27 Oct. 1998
South East Water Ltd	30 June 1998	31 Oct. *Financial Management Act* 1994, s.53A.	2 Sept. 1998	2 Sept. 1998
South Gippsland Region Water Authority	30 June 1998	31 Oct. *Financial Management Act* 1994, s.46.	20 Aug. 1998	15 Sept. 1998
South West Water Authority	30 June 1998	" "	8 Sept. 1998	11 Sept. 1998
South Western Regional Waste Management Group	Period 9 Dec. 1997 to 30 June 1998	" "	4 Mar. 1999	18 Mar. 1999
Sunraysia Rural Water Authority	30 June 1998	" "	7 Oct. 1998	7 Oct. 1998
Victorian Dairy Industry Authority	30 June 1998	" "	19 Aug. 1998	18 Sept. 1998
Victorian Dried Fruits Board *(a)*	30 June 1998	" "	13 Nov. 1998	23 Nov. 1998
Victorian Meat Authority	30 June 1998	" "	6 Aug. 1998	9 Sept. 1998
Victorian Plantations Corporation	30 June 1998	" "	27 Aug. 1998	28 Aug. 1998
Victorian Strawberry Industry Development Committee	30 June 1998	" "	30 Sept. 1998	9 Oct. 1998
Water Training Centre	30 June 1998	" "	2 Oct. 1998	5 Oct. 1998
West Gippsland Catchment Management Authority	30 June 1998	" "	6 Oct. 1998	8 Oct. 1998
Western Region Water Authority	30 June 1998	" "	7 Sept. 1998	15 Sept. 1998
Westernport Region Water Authority	30 June 1998	" "	18 Aug. 1998	15 Sept. 1998

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*				
AGRICULTURE AND RESOURCES *- continued*				
Wimmera Catchment Management Authority	30 June 1998	31 Oct. *Financial Management Act* 1994, s.46.	2 Sept. 1998	23 Sept. 1998
Wimmera Mallee Rural Water Authority	30 June 1998	" "	3 Sept. 1998	3 Sept. 1998
Yarra Valley Water Ltd	30 June 1998	31 Oct. *Financial Management Act* 1994, s.53A.	21 Aug. 1998	31 Aug. 1998
CONSERVATION AND LAND MANAGEMENT				
Alpine Resorts Commission *(a)*	Period 1 Nov. 1997 to 29 Apr. 1998	31 Oct. *Financial Management Act* 1994, s.46.	28 Aug. 1998	25 Jan. 1999
Eco Recycle Victoria	30 June 1998	" "	28 Sept. 1998	30 Sept. 1998
Environment Protection Authority	30 June 1998	" "	9 Sept. 1998	30 Sept. 1998
Northern Regional Waste Management Group	30 June 1998	" "	3 Dec. 1998	11 Jan. 1999
Melbourne Parks and Waterways	Period 1 July 1997 to 2 July 1998	" "	7 Aug. 1998	7 Aug. 1998.
Mildura Regional Waste Management Group	Period 13 Nov. 1997 to 30 June 1998	31 Oct. *Financial Management Act* 1994, s.46	20 Apr. 1999	10 May 1999
Phillip Island Nature Park Board of Management	30 June 1998	" "	30 Sept. 1998	23 Oct. 1998
Royal Botanic Gardens Board	30 June 1998	" "	18 Aug. 1998	8 Sept. 1998
Shrine of Remembrance Trustees	30 June 1998	No reporting requirements.	30 Oct. 1998	6 Nov. 1998
South Eastern Regional Waste Management Group	30 June 1998	31 Oct. *Financial Management Act* 1994, s.46.	24 Sept. 1998	22 Oct. 1998
Surveyors Board of Victoria	30 June 1998	" "	29 Oct. 1998	9 Nov. 1998

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*				
CONSERVATION AND LAND MANAGEMENT *- continued*				
Trust for Nature (Victoria)	30 June 1998	31 Oct. *Financial Management Act* 1994, s.46.	22 Sept. 1998	23 Sept. 1998
Western Regional Waste Management Group	30 June 1998	" "	10 Dec. 1998	19 Feb. 1999
Yarra Bend Park Trust	30 June 1998	31 Oct. *Financial Management Act* 1994, s.46.	8 Oct. 1998	18 Nov. 1998
Zoological Parks and Gardens Board	30 June 1998	" "	7 Sept. 1998	7 Sept. 1998
INCOMPLETE AUDITS				
AGRICULTURE AND RESOURCES				
Tungamah Shire Water Board	30 June 1998	31 Oct. *Financial Management Act* 1994, s.46.	Financial statements not received.	
Veterinary Practitioners Registrations Board of Victoria	31 Dec. 1998	30 April. *Financial Management Act* 1994 s.46.	" "	
CONSERVATION AND LAND MANAGEMENT				
Eastern Regional Waste Management Group	30 June 1998	31 Oct. *Financial Management Act* 1994, s.46.	Audit completed. Awaiting certified financial statements.	
Grampians Regional Waste Management Group	Period 30 Oct. 1997 to 30 June 1998	" "	Financial statements not received.	
Highland Regional Waste Management Group	Period 18 Dec. 1997 to 30 June 1998	" "	Audit completed. Awaiting certified financial statements.	
State Swimming Centre Committee of Management	30 June 1995	" "	Audit completed. Awaiting certified financial statements.	
" "	30 June 1996	" "	" "	
" "	30 June 1997	" "	" "	
" "	Period 1 July 1997 to 31 Dec. 1997	30 April. *Financial Management Act* 1994, s.46.	" "	

(a) Final audit.

Part 3.6

Premier and Cabinet

KEY FINDINGS

Museum development project

- The Melbourne Museum complex which was originally estimated to cost $250 million has now been revised to cost $287.6 million at completion, with the increase mainly attributable to a change in scope of the complex, lack of detailed costings relating to the public exhibition program, and problems encountered with the treatment and removal of contaminated soil and water seepage not envisaged prior to the commencement of the excavation works.
  Paras 3.6.17 to 3.6.24
- Project delays have resulted in a need for the opening date for the Museum to be moved back by 6 months, with the revised opening date now being in July 2000.
  Paras 3.6.21 to 3.6.22
- While the IMAX theatre became operational in May 1998, audit has been unable to determine whether revenue earned from the theatre has met expectations to date due to the management of Museum Victoria refusing to provide audit access to this information on account of commercial-in-confidence considerations. In my view, the position taken by management is inappropriate and should not be acceptable to the Parliament as it prevents independent assessments on behalf of Victorian taxpayers of the financial status of this arrangement.
  Paras 3.6.40 to 3.6.44

3.6.1 The Premier, who is also the Minister for the Arts and Multicultural Affairs, has responsibility for operations within the Premier and Cabinet portfolio.

3.6.2 Details of the specific ministerial responsibilities for public bodies within the Premier and Cabinet portfolio are listed in Table 3.6A. These public bodies, together with the Department of the Premier and Cabinet, were subject to audit by the Auditor-General during the 1997-98 financial year.

TABLE 3.6A
MINISTERIAL RESPONSIBILITY FOR
PUBLIC SECTOR AGENCIES WITHIN THE PREMIER AND CABINET PORTFOLIO

Ministerial portfolio	*Agencies subject to audit*
Arts	Council of Trustees of the National Gallery of Victoria Geelong Performing Arts Centre Trust Library Board of Victoria Melbourne 2006 Commonwealth Games Bid Pty Ltd Museums Board of Victoria National Gallery Society of Victoria State Library of Victoria Foundation Victorian Arts Centre Trust
Multicultural Affairs	Victorian Interpreting and Translating Service
Premier	Office of the Ombudsman The Office of Public Employment Victorian Relief Committee

3.6.3 Comment on matters of significance arising from the audit of entities within the Premier and Cabinet portfolio is provided below.

STATUS OF THE MELBOURNE MUSEUM COMPLEX CONSTRUCTION

Project profile

3.6.4 In February 1988, the then Minister for the Arts announced a project involving the redevelopment and expansion of the State Library of Victoria and the relocation of the Museum of Victoria, from the existing Swanston Street site to a new site then proposed to be the Southbank precinct of Melbourne. Works on the proposed new Museum site began in November 1990, with around $20 million spent on the project up to the time of the October 1992 State election.

3.6.5 With a change of Government occurring in late 1992, the plans regarding the Museum development were revised. In particular, the State Government in May 1993 announced, as part of it *Agenda 21 program* of civic works, the construction of a world class museum to store the State's collection, however, the new museum was to be situated at the Carlton Gardens, and not Southbank as previously proposed. To facilitate the development, responsibility for the Royal Exhibition Building which is located next to the development was transferred to the Council of the Museum of Victoria in April 1996.

3.6.6 Under the Government's revised development plans, the original Southbank site for the Museum on which construction had commenced was to be used as a Melbourne Exhibition Centre, which would be a leading venue for trade and business exhibitions and major events.

3.6.7 **Commencement of the construction works of the Museum located at the Carlton Gardens were to begin in late 1995 and were to be completed by early 2000, at an overall estimated cost of $250 million.**

Selection of design and construction contractor

3.6.8 In January 1994, the Government announced a national competition to design the new Melbourne Museum Complex (the Museum). A total of 109 entries were received from architects, both nationally and internationally, from which a shortlist of 5 entries was determined by an independent panel. All shortlisted entrants were requested to provide detailed plans of their proposals for assessment. Subsequently, in June 1994, a firm of Melbourne-based architects was announced as the successful designer of the Museum, and in May 1995, the final design of the Museum was unveiled by the Premier.

3.6.9 Among the key features of the proposed Museum development were a Gallery of Life, an Aboriginal Centre, a Children's Museum, 3 large exhibition galleries, an 8 storey IMAX theatre, a modern education centre, a library and a range of public facilities and eating areas. In addition, the historic Royal Exhibition Building, which was to be fully restored and the adjoining post-World War II exhibition structures demolished, was to be linked to the Museum via an underground tunnel.

3.6.10 In September 1996, the Office of Major Projects which forms part of the Department of Infrastructure, invited 6 of Australia's largest building contractors to submit tenders for the main construction contract for the Museum. All tenders were received by mid-November 1996 and were assessed by that Office, with the successful contractor awarded the contract with a value of $162 million in December 1996.

3.6.11 At that time, the expected completion date for the IMAX theatre was late 1997, while the Museum building works were to be finalised by June 1999, with the first exhibitions installed in early 2000.

Model design of the new Melbourne Museum Complex.

Management and funding arrangements

3.6.12 Under the established arrangements, the construction of the Museum is managed by the Office of Major Projects on behalf of Arts Victoria within the Department of Premier and Cabinet and the Museums Board of Victoria (Museum Victoria) under the provisions of the *Project Development and Construction Management Act* 1994. The Act provides the Office of Major Projects with the powers necessary to facilitate the delivery of the project, including the ability to borrow, enter into contracts, and acquire and dispose of land.

3.6.13 Museum Victoria is responsible for the authorisation, monitoring and control of all aspects of the Museum project, other than the construction of the facility. These responsibilities include:

- primary design and fit-out of public spaces;
- design and construction of public exhibition programs;
- re-location of collections; and
- acquisition of furniture, fittings and equipment.

3.6.14 A Project Control Group, comprising of representatives from Arts Victoria within the Department of Premier and Cabinet and Museum Victoria, was established by the Office of Major Projects to facilitate inter-departmental communication and liaison concerning project costs, scope and scheduling. In addition, a private sector project manager has been engaged by the Office of Major Projects to monitor the progress of the project on its behalf.

3.6.15 Under the Government's *Agenda 21 program*, funding for the Museum project, which initially had a project budget of $250 million excluding non-government funding, is to be provided by Arts Victoria within the Department of Premier and Cabinet from casino revenues collected by the State. Under the established arrangements, the Office of Major Projects can draw-down these funds to pay all costs associated with the project including costs incurred by Museum Victoria.

3.6.16 In addition to the funding of $250 million provided via Arts Victoria, Museum Victoria also planned to supplement the public exhibition program via funding through a sponsorship campaign with an original target of $10 million.

Construction of the Museum

3.6.17 The audit examination revealed that **the projected final cost of completing the Museum project as at 28 February 1999 was $287.6 million, which represented an additional cost of $37.6 million compared with the original budget. The additional costs are to be funded through a $13 million capital works allocation supplement by the State Government, with the balance of $24.6 million to be funded through sponsorship, contributions by Cinema Plus (the operator of the IMAX theatre) and the collection of IMAX theatre rental and car parking fees.** Table 3.6B illustrates the projected final cost of the project.

TABLE 3.6B
MUSEUM PROJECT BUDGET, AT JUNE 1995 AND FEBRUARY 1999
($million)

Cost component	*Original budget (June 1995)*	*Projected final cost (February 1999)*
Construction contracts and fees	*(a)*179.1	*(a)* 217.6
Off-site store construction and fit-out	7.4	6.7
Public exhibition program	30.0	48.0
Fittings, furniture and equipment	9.7	7.5
Project management and development costs of Museum Victoria	1.7	4.7
Collection re-location	3.1	3.1
Minister's discretionary fund (unallocated funds)	19.0	nil
Total project cost	**250.0**	**287.6**

(a) Includes contingency sums.

3.6.18 While the project is now estimated to cost around $37.6 million more than initially estimated, this additional cost is determined after taking into account cost savings of $1.8 million to be obtained through the:

- deletion of the painting of car park walls and ceilings;
- downgrading of the quality of fittings, including ceiling tiles, flooring, carpets, and paving;
- deletion of the proposed underground linkage from the Royal Exhibition Building to the Museum; and
- use of alternative landscape treatment for the Aboriginal Centre courtyard.

3.6.19 **Audit was advised that the cost of adding the underground linkage after the Museum is complete would be considerably greater compared with a cost of around $300 000 if it was constructed as part of the initial project.**

Key factors impacting on the project's costs

3.6.20 The following key factors have contributed to the project cost overrun of $37.6 million as at February 1999, which has been funded from either the project's contingency budget, the Minister's discretionary fund, contributions by Cinema Plus and the collection of IMAX theatre revenues and car parking fees:

- increase in the size of the associated car park from 600 to 900 spaces at an additional cost of $8.3 million;
- expansion of the public exhibition program, resulting in the increase in associated costs from $30 million to $48 million, mainly due to a previous lack of detailed costings; and
- increased scope of works associated with the IMAX theatre at the time when entering into an agreement with Cinema Plus, including difficulties experienced in the treatment and removal of contaminated soil and water seepage from the site, at an additional overall cost of $17 million.

Time delays

3.6.21 **Project delays have resulted in a need for the opening date for the Museum to be moved back by 6 months, with the revised opening date now being in July 2000.** Table 3.6C indicates the initially proposed and the actual or currently proposed timeframes associated with the project.

TABLE 3.6C
PROPOSED AND ACTUAL/REVISED TIMEFRAMES FOR MUSEUM

Milestone	*Initially proposed timeframe*	*Actual/revised timeframe*
Tender of construction contract	May 1996	September 1996
Letting of construction contract	August 1996	December 1996
Completion of construction	April 1999	November 1999
Public opening	December 1999	July 2000

3.6.22 The major reasons for the delays as reported in the Project Control Group minutes are as follows:

- impact of soil contamination and water seepage on excavation;
- later than expected occupation of the site by the contractor; and
- delays in the finalisation of the design of the extended car park.

3.6.23 **The Melbourne Museum complex which was originally estimated to cost $250 million has now been revised to cost $287.6 million at completion, with the increase mainly attributable to a change in scope of the complex, lack of detailed costings relating to the public exhibition program, and problems encountered with the treatment and removal of contaminated soil and water seepage not envisaged prior to the commencement of the excavation works.**

3.6.24 **Notwithstanding this significant increase in costs, it is anticipated that upon the completion of the project Victoria will have a museum which will be comparable to other world class museums and enable the exhibition of the State's valuable collection.**

IMAX theatre development

3.6.25 As early as 1988, it was planned that an IMAX theatre was to be constructed as part of the Museum project. Museum Victoria in October 1988 entered into an agreement with the IMAX Corporation for the lease of an OMNIMAX projection system and an accompanying sound system, as part of the original plan to construct the Museum at the Southbank precinct. Although Museum Victoria did not take delivery of this original system, it paid an amount of US$1.1 million in rental under this Agreement. This payment was not refunded, however, it secured the option for Museum Victoria to re-activate the agreement in the future.

3.6.26 With the change in the site for the Museum from Southbank to Carlton, the IMAX Corporation and Museum Victoria agreed to vary the terms of the original agreement through a Variation Agreement, which substituted the delivery of the OMNIMAX system with an IMAX projection system, sound system and screen.

3.6.27 In March 1996, Museum Victoria announced an arrangement with Cinema Plus to develop the IMAX theatre as part of the new Museum project under which Cinema Plus would invest in, promote, manage and operate the IMAX theatre on behalf of Museum Victoria. At this time, it was also agreed that the theatre would open prior to the completion of the Museum.

3.6.28 The original IMAX equipment lease referred to above (incorporating variations) was assigned to Cinema Plus in August 1996. An Agreement to Lease the premises on which the cinema complex was to be built and the IMAX projection system installed, was also executed at this time.

Entrance to the IMAX theatre; part of the new Museum complex.

3.6.29 The total estimated construction cost of the IMAX theatre, as specified in the Agreement to Lease, was $10.6 million and comprised the necessary structural works, key external works and fit-out. Under this agreement, the following contributions were required to be made by Cinema Plus towards the IMAX theatre construction:

- $2 million to be applied towards fit-out works on the premises, including the purchase and installation of projection and other capital equipment, and the fit-out of the retail and catering areas within the theatre complex; and
- $10 million to be applied towards the cost of construction of the IMAX and the fit-out of the theatre.

3.6.30 Cinema Plus was also required to provide Museum Victoria with a banker's undertaking of $10 million before 1 October 1996, as security for performance of its obligations.

Delays in completion of IMAX theatre

3.6.31 The IMAX theatre opened in May 1998, which was **7 months later than originally planned.** The initially proposed and actual/revised timetable for the tendering, construction and opening of the IMAX theatre is illustrated in Table 3.6D.

TABLE 3.6D
INITIALLY PROPOSED AND ACTUAL/REVISED TIMEFRAME FOR IMAX THEATRE

Milestone	*Initially proposed timeframe*	*Actual/revised timeframe*
Tender of IMAX (concrete structure) construction contract	August 1996	August 1996
Letting of IMAX (concrete structure) construction contract	September 1996	November 1996
Completion of IMAX construction	March 1997	December 1997
Public opening of theatre	October 1997	May 1998

3.6.32 The table shows that, while the contract for the construction of the IMAX theatre concrete shell was initially intended to be let by September 1996, it was not formally let until November 1996. This was predominantly due to soil contamination issues which needed to be addressed and the tenders requiring further evaluation as the value of all tenders that were received was above the internally estimated costings. Subsequent construction delays, predominantly caused by water seepage, consequential revisions to the waterproofing system and delays during excavation works, led to the replacement of the contractor in April 1997, at a cost of approximately $1.7 million financed from the project's contingency fund.

3.6.33 **The above delays in the construction of the theatre resulted in the implementation of an acceleration program at a cost of $1.45 million to facilitate an opening of 3 March 1998.** Cinema Plus contributed $1 million towards this cost, with the remaining $450 000 funded from the project's contingency budget on the basis that Cinema Plus would waive their right to pursue liquidated damages for the period up until 3 March 1998.

3.6.34 At this time, Cinema Plus also determined that the same contractor would undertake the IMAX fit-out contract instead of the contractor originally planned. As a result of facility upgrades, it was estimated that the cost of the theatre fit-out would amount to $5.8 million compared with the original estimate of $4 million. This cost overrun was also met from the project's contingency budget. Substantial delays in the fit-out works also arose mainly due to:

- changes to the fit-out designer by Cinema Plus in November 1997 and consequential changes to the interior design of the theatre;
- delays by Cinema Plus in providing a guarantee of funds for the retail fit-out of the theatre; and
- industrial action.

Construction Costs Deed

3.6.35 In June 1998, an IMAX Construction Costs Deed, negotiated between Museum Victoria and Cinema Plus, was executed to resolve disputes over the payment of costs associated with the construction and fit-out of the IMAX theatre.

3.6.36 Under the terms of the Deed, no damages for late completion were payable by either Cinema Plus or Museum Victoria. This arrangement recognised the difficulties of completing all necessary works and opening the IMAX theatre by the original dates and the efforts of both parties in seeking to accelerate the works to overcome time lost for reasons beyond the control of either party.

3.6.37 The Deed required payment by Cinema Plus of an amount of $13.8 million, which Cinema Plus accepted as the amount owed to Museum Victoria. Cinema Plus was also required to lodge an additional $4 million security in an escrow account pending the outcome of negotiations regarding the allocation of certain disputed costs, with the consequential release of the security previously lodged by Cinema Plus under the Agreement to Lease.

3.6.38 In negotiating the Deed, a new date for the payment by Cinema Plus of the capital contribution was accepted, and the agreed contribution of $13.8 million was received by Museum Victoria from Cinema Plus in June 1998, comprising:

- a capital contribution of $4.2 million;
- cost of fit-out works $5.8 million;
- cost of special fit-out $2.7 million;
- contribution to construction acceleration costs of $1 million; and
- cost of additional foyer area of $143 000.

3.6.39 **The construction costs and fit-out of the IMAX theatre totalling $23.6 million, which form part of the overall Museum complex, have been met by Museum Victoria ($5.8 million) and the theatre operator ($13.8 million), with a further amount of $4 million still to be allocated between the 2 parties.**

Lease and Operating Agreement

3.6.40 The Lease Agreement between Cinema Plus and Museum Victoria commenced in May 1998 and covers a period of 25 years. It is also accompanied by an Operating Agreement which sets out the terms and conditions for the operation of the IMAX theatre.

3.6.41 Under the arrangements, rental is payable by Cinema Plus to Museum Victoria at a base rate of $250 000 per annum plus:

- 7 per cent of gross revenue above $4 million and up to $7.5 million per annum; and
- 10 per cent of gross revenue above $7.5 million per annum.

3.6.42 Furthermore, Cinema Plus is required to spend at least $300 000 per annum on the promotion of the cinema complex in the first 2 years of its operation, and during the remainder of the term, the greater of:

- 3 per cent of gross revenue up to $10 million, plus 2 per cent of gross revenue above $10 million up to $15 million, and 1 per cent of gross revenue above $15 million; or
- $250 000.

3.6.43 In respect of the financial performance of the IMAX theatre, provisions have been included in the Lease Agreement which enable Museum Victoria to re-enter and re-possess the premises or terminate the lease *inter alia* if:

- the gross revenue from the operation of the theatre for each of the first 4 years of the lease is not sufficient to cover the total operating costs for each of these years;
- the gross revenue from operation of the theatre for any 2 consecutive years after the first 4 years of the lease is not sufficient to cover the total cost of operating the theatre for those 2 years; or
- the number of paying patrons attending the theatre is less than 250 000 patrons in the first or second years of the lease, or 450 000 patrons in the third or subsequent years of the lease.

3.6.44 **While the IMAX theatre became operational in May 1998, audit has been unable to determine whether revenue earned from the theatre has met expectations to date due to the management of Museum Victoria refusing to provide audit access to this information on account of commercial-in-confidence considerations. I consider that the position taken by management is inappropriate and should not be acceptable to the Parliament as it prevents independent assessments on behalf of Victorian taxpayers of the financial status of this arrangement.**

❒ ***RESPONSE*** *provided by Secretary, Department of Premier and Cabinet on behalf of the Department, Museum Victoria and the Office of Major Projects*

The above Report has recognised the substantial increase in the scope of the Melbourne Museum project since its initial announcement in 1993 which has necessitated an increase to the initial project budget which was set at $250 million.

A larger IMAX Theatre (+$17 million), an additional 300 underground car spaces (+$8.3 million) and an increase in the scope of exhibition program (+$18 million) have been the major elements contributing to the overall increase in project scope. The additional funds required to cover this increase are being provided by the IMAX operator (Cinema Plus) the State Government and Museum Victoria.

During the construction phase, the Museum has also undertaken value management exercises to keep the project within the revised budget.

Your Report addresses the notional delays in the delivery/completion of the Museum project, but because they seem to be reasonably explained in the Report, I offer no additional comment.

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 ARTS CENTRE TRUST		
Ministerial Portfolios, May 1994, pp. 58-9.	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 impaired decision-making and has impaired transparency and accountability to the Parliament.	As part of a new financial management information system, which became operational on 1 January 1999, the Trust has allocated funding to develop a costing model which will facilitate the allocation of indirect overheads to operating units for financial reporting purposes. It is anticipated that the model will be finalised in time for this information to be included in the 1998-99 financial statements.
Ministerial Portfolios, May 1994, pp. 68-9.	Since 1987, the Trust has pursued legal action to recover damages against a number of contractors and consultants over defects in the Arts Centre spire.	A final settlement in favour of the Trust was achieved during 1997-98. The net amount of the settlement after expenses reported in the Trust's 1997-98 annual report was $1.1 million.

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 Premier and Cabinet	30 June 1998	31 Oct. *Financial Management Act* 1994, s.46.	31 Aug. 1998	31 Aug. 1998
ARTS				
Council of Trustees of the National Gallery of Victoria	30 June 1998	" "	26 Aug. 1998	14 Sept. 1998
Geelong Performing Arts Centre Trust	30 June 1998	" "	10 Sept. 1998	16 Sept. 1998
Library Board of Victoria	30 June 1998	" "	28 Sept. 1998	28 Sept. 1998
Melbourne 2006 Commonwealth Games Bid Pty Ltd	30 June 1998	31 Oct. *Financial Management Act* 1994, s.53A.	22 July 1998	22 July 1998
Museums Board of Victoria	30 June 1998	31 Oct. *Financial Management Act* 1994, s.46.	23 Sept. 1998	23 Sept. 1998
National Gallery Society of Victoria	Period 1 April 1997 to 30 June 1998	" "	26 Aug. 1998	9 Sept. 1998
State Library of Victoria Foundation	30 June 1998	" "	28 Sept. 1998	28 Sept. 1998
Victorian Arts Centre Trust	30 June 1998	" "	15 Oct. 1998	16 Oct. 1998
MULTICULTURAL AFFAIRS				
Victorian Interpreting and Translating Service	30 June 1998	" "	7 Dec. 1998	10 Dec. 1998
PREMIER				
Office of the Ombudsman	30 June 1998	" "	24 Sept. 1998	24 Sept. 1998
Office of the Public Service Commissioner *(a)*	30 June 1998	" "	16 Sept. 1998	16 Sept. 1998
Victorian Relief Committee	30 June 1998	" "	26 Oct. 1998	30 Oct. 1998

(a) From July 1998, known as The Office of Public Employment.

Part 3.7

State Development

KEY FINDINGS

Harness Racing Board - awarding of computer contract

- The minutes of the meetings of the Board failed to provide any justification for the Board's action of conducting a selective tendering process for the engagement of an external provider for the implementation of its new racing information system, instead of inviting public tenders.

  Paras 3.7.7 to 3.7.11

- To ensure that the Board's procurement activities are conducted in a transparent and justifiable manner, the Board should develop formal purchasing policies and guidelines based on those promulgated by the Victorian Government Purchasing Board.

  Paras 3.7.10 to 3.7.14

3.7.1 The Minister for Industry, Science and Technology, the Minister for Information Technology and Multimedia, the Minister for Sport and Rural Development and the Minister for Small Business and Tourism have responsibility for operations within the State Development portfolio. These Ministers have collective responsibility for the Department of State Development.

3.7.2 Details of the specific ministerial responsibilities for public bodies within the State Development portfolio are listed in Table 3.7A. These public bodies, together with the Department of State Development, were subject to audit by the Auditor-General during the 1997-98 financial year.

TABLE 3.7A
MINISTERIAL RESPONSIBILITIES FOR
PUBLIC BODIES WITHIN THE STATE DEVELOPMENT PORTFOLIO

Ministerial portfolio	*Entities subject to audit*
Industry, Science and Technology	Melbourne Convention and Exhibition Trust
	Overseas Projects Corporation of Victoria Ltd
	Victorian Medical Consortium Pty Ltd
Information Technology and Multimedia	Cinemedia Corporation
Small Business	Liquor Licensing Commission
Sport	Greyhound Racing Control Board
	Harness Racing Board
	Melbourne and Olympic Parks Trust
	Melbourne Sports and Aquatic Centre Trust
	Victorian Institute of Sport Ltd
	Victorian Institute of Sport Trust
Tourism	Australian Grand Prix Corporation
	Emerald Tourist Railway Board
	Tourism Victoria

3.7.3 Comment on matters of significance arising from the audit of entities within the State Development portfolio is provided below.

HARNESS RACING BOARD - AWARDING OF COMPUTER CONTRACT

3.7.4 In April 1995, the Harness Racing Board publicly sought expressions of interest from external parties for the development of a business change program, including the identification of the Board's information system requirements. Following the receipt of 10 expressions of interest, in May 1995 the Board short-listed 5 proposals for further scrutiny.

3.7.5 Following further consideration of the short-listed proposals, the Board subsequently concluded that negotiations should occur with the nominated preferred tenderer, as their proposal was considered to present the most professional bid. This view was consistent with the results of an evaluation of the short-listed proposals by an independent consultant who considered that the favoured proposal was the best prepared and showed a good understanding of the Board's requirements. However, the consultant identified two reservations, being the preferred tenderer's lack of industry experience, which was not considered a major exposure, and the high cost of the proposal.

3.7.6 Later in May 1995, the preferred tenderer was formally appointed by the Harness Racing Board to conduct the business change program at a cost of $130 000. The Treasurer of the Board, who is a partner of a related firm associated with the preferred tenderer, appropriately excluded himself from the appointment decision.

3.7.7 Following the completion of its business process review in October 1995, the successful tenderer (the contractor) presented a number of key recommendations to the Board, including the:

- development and implementation of a new racing information system;
- implementation of a new organisation structure and culture;
- implementation of identified short-term improvements; and
- re-engineered registration, licence and racing processes.

3.7.8 Subsequently, in March 1996, the Board was advised by the contractor that the horse administration system of Harness Racing New Zealand should be used as the basis for the development of a new racing information system for the Board, at a proposed cost of $1.3 million. At a subsequent meeting in April 1996, the Board resolved to seek a second proposal from a firm of information technology consultants, with costings for the replacement or upgrade of the Board's computer system, based on the appointed contractor's business change program review.

3.7.9 The proposal submitted by the consultants in June 1996 included a costing of $1.7 million for the development of a racing information system and an additional amount of $200 000 for the acquisition of associated hardware and the provision of training. As this quotation was higher than the proposal provided by the contractor, which identified an overall cost of $1.7 million ($1.3 million for the development of a racing information system and $400 000 for the purchase of hardware and the provision of training), in July 1996 the Board resolved to appoint the contractor to undertake the project, with a completion date of 30 June 1997. The Treasurer of the Board again excluded himself from the decision.

3.7.10 **The audit review of the engagement of this contractor identified that the Board did not have any documented procurement policies and guidelines, which prescribed the appropriate processes to be followed in relation to major acquisitions. In addition, the processes adopted by the Board for the appointment were not consistent with the policies and guidelines of the Victorian Government Purchasing Board, which require that agencies should generally invite public tenders where the estimated value of goods or services to be purchased exceeds $50 000.**

3.7.11 **Furthermore, the minutes of the meetings of the Board failed to provide any justification for the Board's action of conducting a selective tendering process for the engagement of an external provider for the implementation of its new racing information system.**

3.7.12 At the date of preparation of this Report, the Board's management had advised that the cost of the project was $1.4 million and, although certain technical difficulties delayed the actual commencement of the system by the agreed date, the system was now fully operational.

3.7.13 In addition, the Board's management advised that in December 1998 the Board had entered into a joint venture arrangement with the Harness Racing Board of New South Wales to share the use of the system whereby the latter paid $400 000 at the date of signing the relevant agreement and is due to pay an additional $450 000 by 31 December 1999, as a contribution towards costs incurred by the Board for the development of the racing information system.

3.7.14 **To ensure that the Board's procurement activities are conducted in a transparent and justifiable manner, the Board should develop formal purchasing policies and guidelines based on those promulgated by the Victorian Government Purchasing Board.**

❒ ***RESPONSE*** *provided by the Chairman of the Harness Racing Board*

The Board considered that only 2 tenders could adequately deliver the Board's information technology needs in relation to a complete rewrite of the racing system and, therefore, dealt with 2 tenders only.

The Board will develop formal purchasing policies and guidelines based on those promulgated by the Victorian Government Purchasing Board.

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 State Development	30 June 1998	31 Oct. *Financial Management Act* 1994, s.46.	16 Sept. 1998	16 Sept. 1998
INDUSTRY, SCIENCE AND TECHNOLOGY				
Melbourne Convention and Exhibition Trust	30 June 1998	31 Oct. *Financial Management Act* 1994, s.46.	31 Aug. 1998	4 Sept. 1998
Overseas Projects Corporation of Victoria Ltd	30 June 1998	31 Oct. *Financial Management Act* 1994, s.53A.	2 Oct. 1998	7 Oct. 1998
Victorian Medical Consortium Pty Ltd	30 June 1998	" "	22 Oct. 1998	22 Oct. 1998
MULTIMEDIA				
Cinemedia Corporation	30 June 1998	31 Oct. *Financial Management Act* 1994, s.46.	7 Sept. 1998	8 Sept. 1998
SMALL BUSINESS				
Liquor Licensing Commission	30 June 1998	" "	17 Sept. 1998	28 Sept. 1998
SPORT				
Greyhound Racing Control Board	30 June 1998	" "	30 Sept. 1998	30 Sept. 1998
Harness Racing Board	30 June 1998	" "	5 Sept. 1998	15 Sept. 1998
Melbourne and Olympic Parks Trust	30 June 1998	" "	28 Sept. 1998	28 Sept. 1998
Melbourne Sports and Aquatic Centre Trust	30 June 1998	" "	28 Sept. 1998	30 Sept. 1998
Victorian Institute of Sport Ltd	30 June 1998	31 Oct. *Financial Management Act* 1994, s.53A.	19 Aug. 1998	28 Aug. 1998
Victorian Institute of Sport Trust	30 June 1998	31 Oct. *Financial Management Act* 1994, s.46.	19 Aug. 1998	28 Aug. 1998
TOURISM				
Australian Grand Prix Corporation	30 June 1998	" "	28 July 1998	28 July 1998
Emerald Tourist Railway Board	30 June 1998	" "	24 Aug. 1998	2 Oct. 1998
Tourism Victoria	30 June 1998	" "	25 Sept. 1998	25 Sept. 1998

Part 3.8

Treasury and Finance

KEY FINDINGS

Sale of Victorian Plantations Corporation

- The State received gross proceeds of $550 million during the 1998-99 financial year for the sale of the Victorian Plantations Corporation's (VPC) net assets which, in the main, comprised around 115 000 hectares of timber plantations situated on around 166 000 hectares of land.

  Paras 3.8.4 to 3.8.39

- The proceeds received by the State were around $201 million in excess of the book value of the plantation business, mainly representing the value placed by the purchaser on the perpetual rights granted by the State in relation to the occupation and management of Crown land vested in the VPC for plantation purposes.

  Paras 3.8.38 to 3.8.42

- The costs incurred by the Department of Treasury and Finance and the VPC in relation to the sale of the VPC business totalled around $7 million, with a substantial part of these costs related to the engagement of consultants and contractors to advise and assist in the sale process.

  Para. 3.8.43

- Audit identified that 8 engagements of consultants and contractors with individual contract values exceeding $50 000, having an aggregate estimated cost of $5.8 million (actual cost of $4.9 million), were made by the Department not using public tender processes but by using selective tendering or direct appointment processes.

  Paras 3.8.44

KEY FINDINGS - *continued*

Sale of Aluminium Smelters of Victoria Pty Ltd

- The cash proceeds of $502 million received from the sale of the business compared favourably with the book value and the valuations of the business provided by the Government's financial consultants in July 1998 and immediately before the close of bids in August 1998, on the basis of a trade sale.

Paras 3.8.56 to 3.8.95

- The net loss to the State from the sale of Aluvic was $8 million after taking account of an amount of $109 million which was applied from the proceeds by the State to fund the closure of Aluvic's foreign exchange hedge book and to meet the State's costs of sale.

Paras 3.8.85 to 3.8.87

- In placing the overall sale result in context, it is important to recognise that the establishment by the Government in September 1997 of the supplementary power arrangements for the smelter, had the impact of increasing its operating capacity which increased Aluvic's value by around $47 million.

Para. 3.8.88

- While the State has divested its interest in Aluvic, it has retained a related substantial financial exposure associated with the flexible electricity tariff arrangements which had an estimated net value of around $240 million related to its former 25 per cent interest in the Portland smelter.

Para. 3.8.89

Gas industry reform

- In the period between January 1999 and March 1999, the Government announced the sale of the State's 3 "stapled" gas businesses which achieved gross proceeds in the order of $5.3 billion.

Paras 3.8.96 to 3.8.104

- To minimise the likelihood of future disruptions to Victoria's gas supplies, the Government has undertaken a number of initiatives, including the acceleration of certain previously planned gas infrastructure projects to facilitate alternative sources of gas supply to assist in restoring gas supply security levels.

Paras 3.8.105 to 3.8.117

Sale of Bentleigh site by GASCOR

- The sale proceeds from the Bentleigh site of $11.65 million were $4.8 million higher than the property valuation of $6.9 million provided by the Valuer-General in April 1998 and $5.2 million higher than GASCOR's book value for the property.

Paras 3.8.118 to 3.8.127

KEY FINDINGS - *continued*

Financial standing of WorkCover

- The proportion of the scheme's net assets in relation to its outstanding claims liability as at 31 December 1998 was 96 per cent, an improvement of 3.8 per cent from the funding ratio recorded 12 months earlier of 92.2 per cent.

Paras 3.8.128 to 3.8.135

- It is audit's view that due to the magnitude of the outstanding claims liability and the sensitivity of the scheme, the Victorian WorkCover Authority should continue to have the outstanding claims liability valued each half-year by 2 independent external actuaries and recognise the higher assessed value in the body of its financial statements.

Paras 3.8.136 to 3.8.139

Update on player fairness issues in the gaming industry

- The Government, in consultation with the Victorian Casino and Gaming Authority, should establish a firm timeframe for addressing important player fairness issues in the gaming industry and for the taking of action to better meet the needs of players.

Paras 3.8.145 to 3.8.171

3.8.1 The Treasurer and the Minister for Finance and Gaming have responsibility for operations within the Treasury and Finance sector. These Ministers have collective responsibility for the Department of Treasury and Finance.

3.8.2 Details of the specific ministerial responsibility for public bodies within the Treasury and Finance sector are listed in Table 3.8A. These public bodies, together with the Department of Treasury and Finance were subject to audit by the Auditor-General during the 1997-98 financial year.

TABLE 3.8A
MINISTERIAL RESPONSIBILITY FOR
PUBLIC BODIES WITHIN THE TREASURY AND FINANCE SECTOR

Ministerial portfolio	*Entities subject to audit*
Finance	Emergency Services Superannuation Scheme
	Hospitals Superannuation Board
	Local Authorities Superannuation Board
	Regulator General, Office of the
	Victorian Superannuation Board, administering -
	• Parliamentary Contributory Superannuation Fund
	• State Superannuation Fund
	• Victorian Superannuation Fund
	Victorian WorkCover Authority
	Water Industry Superannuation Fund
	Water Industry Superannuation Fund Pty Ltd
Gaming	Tattersall Gaming Machine Division
	Tattersall Sweep Consultation
	Tattersall's Club Keno
	Victorian Casino and Gaming Authority
Treasurer	Aluminium Smelters of Victoria Pty Ltd and its subsidiaries *(a)*
	Australian Power Exchange Pty Ltd
	Chief Electrical Inspector, Office of the
	Ecogen Energy Ltd
	Energy 21 Pty Ltd
	Gas Safety, Office of
	Gas services business Pty Ltd
	Gas Transmission Corporation
	GASCOR
	Gascor Holdings No. 1 Pty Ltd
	Gascor Holdings No. 2 Pty Ltd
	Gascor Holdings No. 3 Pty Ltd
	Gasmart (Vic) Pty Ltd
	Generation Victoria
	Hastings Port (Holding) Corporation
	Ikon Energy Pty Ltd
	Kinetik Energy Pty Ltd
	Loy Yang B Power Station Pty Ltd
	Melbourne Port Corporation
	Multinet (Assets) Pty Ltd
	Multinet Gas Pty Ltd

TABLE 3.8A
MINISTERIAL RESPONSIBILITY FOR
PUBLIC BODIES WITHIN THE TREASURY AND FINANCE SECTOR - *continued*

Ministerial portfolio	*Entities subject to audit*
Treasurer - *cont*	National Power Exchange Pty Ltd
	Port of Geelong Authority *(b)*
	Port of Melbourne Authority *(b)*
	Port of Portland Authority *(b)*
	Quiet Life Ltd
	Rural Finance Corporation
	State Electricity Commission of Victoria
.	State Trustees Ltd
	STL Financial Services Ltd
	Stratus Networks Pty Ltd
	Stratus Networks Assets Pty Ltd
	Terec Limited
	The Albury Gas Company Ltd
	Transmission Pipelines Australia Pty Ltd
	Transmission Pipelines Australia (Assets) Pty Ltd
	Transmission Pipelines Australia (Holdings) Pty Ltd
	Transport Accident Commission and its 5 subsidiaries
	Treasury Corporation of Victoria
	Tricontinental Holdings Ltd and its 4 subsidiaries
	Vicfleet Pty Ltd
	Victorian Channels Authority
	Victorian Electricity Metering Pty Ltd
	Victorian Energy Networks Corporation
	Victorian Funds Management Corporation
	Victorian Managed Insurance Authority
	Victorian Power Exchange Pty Ltd
	Victorian Rail Track
	V/Line Freight Corporation
	Westar Pty Ltd
	Westar (Assets) Pty Ltd

(a) Sold to private sector entity as at 21 August 1998.
(b) Final audit - entity dissolved 10 December 1997.

3.8.3 Comment on matters of significance arising from the audit of entities within the Treasury and Finance sector is provided below.

SALE OF VICTORIAN PLANTATIONS CORPORATION

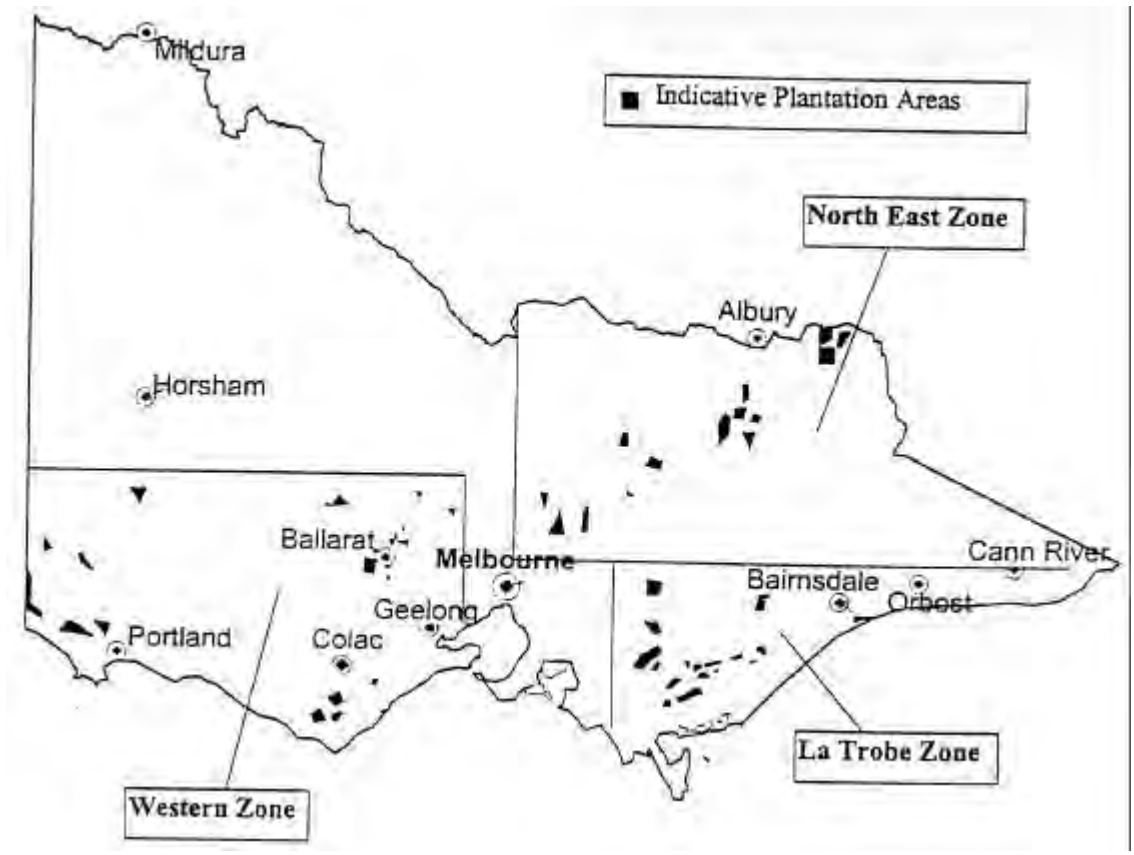
3.8.4 Following the world-wide economic depression of the 1930s and World War II, the State Government established various softwood and hardwood timber plantations in the regional areas of the State in order to attract timber industry participants to these areas and create regional employment opportunities. In doing so, the State committed itself to the long-term supply of timber for commercial purposes.

3.8.5 Until 1993, the State's softwood and hardwood plantations were managed by the former Department of Conservation and Natural Resources. In May 1993, following a government decision to corporatise the plantation business, the Victorian Plantations Corporation (VPC) was established as a State-owned body under the authority of the *State Owned Enterprises Act* 1992. Additional responsibilities and powers relating to the management of Victoria's softwood and hardwood plantations were subsequently conferred on the Corporation under the *Victorian Plantations Corporation Act* 1993. Under the established arrangements, responsibility for the management of the State's native forests remained with the Department of Natural Resources and Environment.

3.8.6 The VPC managed approximately 108 000 hectares of softwood plantation and approximately 7 000 hectares of hardwood plantation, covering a total land area of around 166 000 hectares. Approximately 93 per cent of the land area managed by the VPC comprised Crown land vested in the Corporation under legislation, with a further 4 per cent representing land managed under leasehold arrangements with other public sector agencies and "share-farming" arrangements with local landholders. The remaining portion of VPC land represented freehold properties purchased by the Corporation since its establishment in 1993.

3.8.7 The VPC timber plantations were widely dispersed across the State. Chart 3.8B illustrates the geographical spread of the plantations managed by the VPC.

CHART 3.8B
VPC TIMBER PLANTATIONS



Source: Department of Treasury and Finance.

3.8.8 The chart illustrates that the VPC timber plantations spanned across 3 broad regional zones, including:

- *North-East Zone*, comprising approximately 50 000 hectares of plantations spread over a total land area of 70 000 hectares;
- *Latrobe Zone*, comprising around 28 000 hectares of plantations spread over a land area of 48 000 hectares; and
- *Western Zone*, comprising 37 000 hectares of plantations covering a total land area of 48 000 hectares.

3.8.9 During the 1997-98 financial year, aggregate sales revenue of $79 million was generated by the VPC from the supply of approximately 2 million cubic metres of timber from its plantations to the Victorian timber industry and paper industry processors under various supply arrangements, including:

- *Licences established under the Forest Act 1958* - which generally covered periods of around 15 years and incorporated lower volume commitments;
- *Agreements established under various legislation* - which represented contracts ratified by individual Acts of Parliament and were initially entered into by either the former Forests Commission of Victoria or the former Department of Conservation, Forests and Land. These agreements generally established high volume supply commitments between the parties over periods of between 20 and 40 years and comprised *"take or pay"* provisions for a substantial part of the contracted timber volumes; and
- *Commercial contracts* - which were entered into by the VPC since its establishment for new supply arrangements with customers.

3.8.10 The VPC also managed 2 tree nurseries which supplied planting stock to its plantations and held a one-third interest in a joint venture which exports surplus softwood woodchips sourced from plantations individually owned by the joint venturers.

3.8.11 As part of the Government's wide-ranging reform program of public sector business enterprises, in 1994 the Department of Treasury and Finance engaged a financial consultant to provide advice on certain issues pertaining to the VPC business which required attention prior to consideration by the Government of the possible privatisation of the business.

Key issues impacting on the sale

3.8.12 There were a number of major impediments which needed to be resolved prior to the commencement of a privatisation process for the timber plantation business, with the timber supply contracts and certain land related issues considered by the consultant engaged by the Department to be the most pertinent. In particular, the consultant concluded that:

- The supply agreements with major customers contained various non-commercial terms and conditions which restricted the ability of the Government to assign these agreements to the private sector. A failure by the Government to re-negotiate the long-term legislated agreements to commercial levels would act to limit the value of the business to potential purchasers. However, it was acknowledged that aspects of these agreements were favourable to the VPC, such as the ability of the Corporation to use its discretion in price setting and the inclusion within the agreements of enforceable "*take or pay*" clauses.

  In order to prepare the VPC for privatisation, the consultant recommended that all supply agreements should be placed on a similar commercial footing, which would include the replacement of the discretionary price setting mechanisms with a negotiated market-based pricing mechanism and the re-negotiation of certain other contract terms;

- Given that the majority of the plantations were on Crown land vested in the VPC, existing land titles were inadequate to enable the sale of the VPC to a private sector owner. Accordingly, a complete survey of plantation land would need to be undertaken in order to provide the Corporation with freehold title to the land;
- The indicative valuation of the business was estimated at between $177 million and $246 million, based on discount rates of between 12 and 9 per cent, respectively; and
- The preferred privatisation process for the VPC was a trade sale conducted by way of a competitive tender process. The trade sale process, which would result in the Government's complete removal from the softwood plantation industry, was considered more likely to achieve a higher return to the Government compared with a public share issue and could be implemented more expeditiously.

3.8.13 Based on this advice, in August 1995, the Department of Treasury and Finance sought approval from the Treasurer to proceed with the privatisation of the plantation business. However, given the significance of the issues requiring attention prior to any privatisation of the business, the Treasurer requested the preparation of a discussion paper with a view to determining a future course of action to resolving the above issues. Furthermore, following consultation with the Premier and the Minister for Agriculture and Resources, the Treasurer determined at that time to continue with the corporatisation of the VPC.

3.8.14 In December 1995, following consideration of the discussion paper prepared by the Department, the Treasurer approved the commencement of action to survey and establish freehold titles for Crown land upon which VPC plantations were located, with a target completion date of September 1996. In relation to the agreements established under various legislation, the Treasurer considered it essential that the agreements be converted to commercial contracts. The Treasurer also directed that the process associated with the privatisation of the VPC should continue on the following basis:

- the previously identified issues relating to the plantation land and the supply contracts to be addressed;
- business valuation to be assessed; and
- external advisers not to be engaged at this time, except for obtaining legal advice on commercial contracts and for assistance in the land survey process.

3.8.15 Subsequently, in April 1996, the Department engaged a legal adviser to review the long-term supply agreements with a view to determining the potential assignability of these agreements by the VPC to a prospective purchaser, to determine the level of liability to the State should the Corporation fail to perform its contractual obligations within these agreements, and ascertain whether these contracts could be assigned by means of either:

- establishing a new wholly-owned entity of the State;
- a trade sale of the assets; and
- establishing a new company by way of an initial public float.

3.8.16 However, the legal adviser concluded that it would not be possible to assign the legislated agreements or licences to a VPC successor company without legislative support and that the State may be liable for damages if either the licences or agreements were not assigned or vested in another entity by legislation and the Corporation's contractual obligations were not performed. However, the legal adviser indicated that this outcome could be avoided by either amending the relevant legislation in respect to the agreements established under various legislation, terminating or amending the licences issued under the *Forests Act* 1958, or unwinding the non-legislated agreements through legislation.

3.8.17 Following consideration of the various options available to address this issue, the Treasurer in July 1996 agreed to the re-negotiation of all operative agreements and licences into acceptable commercial contracts, without the support of amendments to legislation.

3.8.18 During the period October 1996 and June 1997, the Department engaged 3 consultants to perform various advisory functions, including the development of a communications strategy in response to key stakeholder concerns regarding the conversion of Crown land to freehold land, and the identification and assessment of future ownership options for the VPC in the context of the current timber industry. **The appointment of these consultants at an estimated total cost of around $166 000, including 2 consultancies that were individually estimated to cost in excess of $50 000, was conducted through a selective tendering process. The Department considered it impractical and inexpedient to pursue a public tender process in relation to these consultancies, given that a decision to privatise the Corporation had not been made by the Government at this time.**

3.8.19 Between March and April 1997, the Department received a series of reports from a previously appointed strategic adviser to assist in its review of the future ownership arrangements, which included:

- *Impact of restrictions to assign land to the purchaser* - the preferred approach would be to transfer to the purchaser a set of legal rights which replicated, as far as possible, ownership of the plantation estate;
- *Options available for sale* - a dual process should be pursued, including a trade sale and a public share issue; and
- *Indicative valuation of the business and the likely proceeds from sale* - the market value of the business, using a number of valuation methodologies was estimated at between $153 million and $412 million. However, the adviser considered that the lower valuation range was a result of limitations of the relevant methodology in capturing the VPC's growth potential.

3.8.20 By August 1997, the land survey of the plantation land which was previously requested by the Treasurer was completed by the Surveyor-General at a cost of $1.7 million. The aim of the survey was to establish the boundaries of the plantation estate in order to obtain clear and secure title to the plantation land.

Ovens plantations, Myrtleford.
(Photo courtesy of Hancock Victorian Plantations.)

Preparation for sale

3.8.21 Given that the supply of softwood timber was not considered to be a core function of the Government, **the Cabinet in October 1997 provided an in-principle approval to the privatisation of the VPC, including all plantation timber, existing supply contracts and other related assets, through an international tender process**. The Government's key objectives in this privatisation included:

- remove the Government as a direct participant from an already competitive timber industry;
- provide an impetus for industry-wide reform within the Victorian and Australian timber industry;
- encourage new investment in softwood plantations and timber processing;
- transfer the risk of plantation ownership to the private sector; and
- provide an environment conducive to increased employment throughout regional Victoria.

3.8.22 **Given that the process for the sale of the VPC was to commence as soon as practicable and was intended to be completed within a tight timeframe by July 1998, the Secretary to the Department of Treasury and Finance in October 1997 approved the establishment of a selective tender process for the engagement of transactional, legal and public relations advisers for the sale, rather than a public tender process as generally required under the Victorian Government Purchasing Board's supply policies and guidelines.**

3.8.23 Subsequently, following a selective tender process involving 15 major firms to provide commercial and financial (transactional) advice in relation to the sale, 5 submissions were received from interested parties. However, an appointment was not made as the nominated shortlisted parties were not considered to satisfy the established selection criteria. In November 1997, a further round of selective tendering involving 2 firms was undertaken, resulting in the approval in December 1997, by the Minister for Agriculture and Resources, the Treasurer and the Victorian Government Purchasing Board of the **appointment of a transaction adviser at an estimated cost of $4 million. Under the terms of appointment, performance fees of $500 000 were payable to the adviser in the event that the sale was finalised no later than March 1999 and the sale proceeds exceeded $350 million.**

3.8.24 **In the period December 1997 to February 1998, the Department engaged further consultants with aggregate estimated fees of $1.3 million through the use of selective tendering processes** to provide advice in relation to the sale, including:

- a communications and issues adviser, at an estimated fee of $110 000 (actual fees paid, $36 000);
- a specialist tax adviser, at an estimated fee of $200 000, with the cost of the engagement to be reviewed once the Information Memorandum was issued to bidders and the volume of additional tax advice became known (actual fees paid, $94 000); and
- a legal adviser, at an estimated fee of $1 million (actual fees paid to the date of preparation of this Report, $546 000).

3.8.25 Subsequently, the legal adviser presented a paper to the Department setting out options for dealing with the agreements established under various legislation in the context of privatisation. The adviser concluded that if it was not possible to change these agreements to commercial contracts prior to privatisation, the preferred approach would be to assign these agreements to the purchaser, requiring the purchaser to carry out the obligations of the VPC which are non-commercial in nature.

3.8.26 In February 1998, the transactional adviser to the Department advised on the issue of establishing *"back-to-back"* supply contracts with the prospective purchaser, which would enable the purchaser to fulfil the Corporation's obligations under those contracts which had not been re-negotiated at that time, and to indemnify the State in the event of non-performance of obligations assumed under the arrangements. The adviser identified that, under this scenario, in the short-term, a VPC *"shell"* would need to remain to facilitate any action that may be brought by VPC customers against either the purchaser or the State for non-performance of obligations.

3.8.27 Further, a specialist forestry adviser was appointed in March 1998 by the Department, at a cost of $216 000, to assist in assessing and advising on the methods, procedures and data used to predict future woodflows of the plantation estate which are critical to determining the value of the estate. This appointment was also made without the establishment of a competitive process as the Department considered it impractical to proceed to either public tender or written quotations for the engagement, given that the selected firm had extensive experience in the conduct of "technical audits" of pine plantations and there was an absence of credible competitors in the wider Asia Pacific region.

Sale process

3.8.28 In March 1998, the Treasurer publicly announced the Government's intention to privatise the VPC business through an international public tender process. Subsequently, the *Victorian Plantations Corporation (Amendment) Act* 1998 was enacted to facilitate the sale of the VPC's assets and associated business interests to the private sector. Under the amendments to the Act:

- the boundaries and dimensions of the plantation land vested in the VPC were clarified;
- the VPC was provided the power to grant or assign to a third party a plantation licence or licences in perpetuity over its vested land; and
- the VPC was empowered to allocate to a new owner its assets and undertakings, including the transfer of VPC's staff.

3.8.29 Subsequently, in early June 1998, the Department sought expressions of interest for the sale of the VPC's assets and undertakings, either as a whole estate or as single regional areas, through advertisement in major Australian and international newspapers and forestry-related publications. At the same time, the appointed transaction advisers approached major international timber companies to create an interest in the sale of the business.

3.8.30 During this time, a report was presented to the Department by the specialist forestry adviser engaged to conduct a technical audit of the plantation yield projections used to estimate the value of VPC's plantation, which concluded that there was *"... no reason to suspect that wood flow predictions expressed in the Corporation's business plan and valuation could not be achieved"*. The consultant was later re-engaged in September 1998, at a cost of $40 000, to provide explanations of the findings of the technical audit to potential bidders.

3.8.31 A probity auditor was also engaged by the Department in late June 1998 to oversee the integrity of the sale process. This engagement was initially subject to an open tender process, however, the process and subsequent inquiries with firms previously indicating an interest in process auditing did not identify a suitable candidate. Consequently, a direct appointment was subsequently made by the Department, at a capped cost of $50 000**. As a condition of the engagement, the Department agreed to pay the cost of the probity auditor's professional indemnity insurance with the Victorian Managed Insurance Authority (which predominantly deals in the provision of insurance services to the public sector), at a total cost of $18 725 over the required 7 year period**. The Department advised audit that it accepted the payment of the auditor's indemnity insurance as part of the arrangements, as there was a limited supply of experienced probity auditors in the market at the time and existing providers were either unable to act due to conflicts of interest with potential purchasers or were otherwise engaged in other privatisation and reform projects.

3.8.32 In relation to the sale, the Department in July 1998 received 31 registrations of interest from potential bidders. Following a review of the proposals by a selection committee, 29 respondents were issued an Information Memorandum to assist in the further development of their bids. The selection committee comprised representatives from the Department of Treasury and Finance, the Department of Natural Resources and Environment and an independent adviser on public sector privatisations. In addition, the legal and transaction advisers engaged by the Department were made available to provide advice to the Committee.

3.8.33 Five indicative bids were subsequently received by the Department in August 1998 and, following completion of a due diligence process by the bidders, the Department received 3 final bids in October 1998.

3.8.34 The criteria used to evaluate the final bids by the selection committee were as follows:

- *Good environmental practices and policies* in respect of plantation management and operations or, where the bidder had no previous experience in the industry, a demonstrable awareness of the regulatory environment within Victoria;
- *Acceptable level of commitment to invest* in plantations and/or timber processing in Victoria and the potential to innovate business opportunities and operations;
- *Demonstrated financial capacity*, based on an assessment of the financial position of the bidder relative to the size of the sale transaction and the nature of external debt and equity funding commitments; and
- *Indicative price*, compared with the State's reserve price and other indicative bids.

3.8.35 **In October 1998, consistent with the recommendation of the selection committee, the Treasurer approved the selection of Hancock Victorian Plantations Pty Ltd to preferred bidder status to acquire the plantation business of the Corporation, and subsequently the Treasurer in November 1998 announced the sale of the plantation business to Hancock Victorian Plantations Pty Ltd.**

3.8.36 At the time of sale, this company was approximately 60 per cent owned by a United States investment company, Hancock Timber Resource Group, and 40 per cent owned by Australian superannuation funds. With the purchase of the VPC business, the Hancock Timber Resource Group manages around 1.2 million hectares of plantations worth around $5 billion across the United States, Canada and Australia.

3.8.37 The probity auditor engaged by the Department to oversee the integrity of the sale process reported that the process was conducted in a fair and equitable manner.

Assessment of sale result and arrangements

3.8.38 In October 1998, the VPC, the Treasurer of Victoria and the purchaser entered into the following key arrangements to facilitate the sale or assignment to the purchaser of the various assets, rights and liabilities previously managed by the VPC:

- *Asset Sale Agreement* - under which the net assets (excluding vested Crown land) and undertakings of the VPC were sold to the purchaser as at the date of sale completion in December 1998;
- *Plantation Licences* - under which the purchaser was granted rights in perpetuity over plantation land, including rights associated with the occupation, management, harvest and re-planting of forest produce on such land; and
- *Forestry Services Agreement* - under which the supply obligations of the VPC under the agreements established under various legislation with the timber industry were sub-contracted to the purchaser on a "back-to-back" basis.

3.8.39 **Under the arrangements, the State received gross proceeds of $550 million during the 1998-99 financial year for the sale of the VPC's net assets which, in the main, comprised around 115 000 hectares of timber plantations situated on around 166 000 hectares of land**. Table 3.8C outlines the key components of the proceeds received by the State.

TABLE 3.8C
VICTORIAN PLANTATIONS CORPORATION
COMPOSITION OF SALE PROCEEDS
($million)

Details	*Amount*
Proceeds in excess of book value	201
Proceeds equal to the State's interest in the book value of the assets sold *(a)*	343
	544
Stamp duty on sale transaction	6
Total proceeds	**550**

(a) Represents the value of net assets sold as disclosed in the most recently available unaudited financial statements of the business as at the date of sale.

3.8.40 The above table discloses that the State received $544 million for the sale of the net assets and undertakings of the Corporation which, at the effective date of sale had a book value of $343 million. In effect, this **resulted in the State obtaining proceeds of around $201 million in excess of the book value of the plantation business, mainly representing the value placed by the purchaser on the perpetual rights granted by the State in relation to the occupation and management of Crown land vested in the VPC for plantation purposes.**

3.8.41 **In addition, the cash proceeds from the sale (excluding stamp duty receipts) were $158 million higher than an indicative VPC business "base" valuation of $386 million provided in August 1998 by the Government's financial advisers prior to the sale.**

3.8.42 The cash proceeds of $550 million received by the VPC from the sale were remitted to the Consolidated Fund and, as at the date of preparation of this Report, were invested with the Victorian Funds Management Corporation pending a decision by the Government on the ultimate application of the funds. The Department of Treasury and Finance has advised that the proceeds are intended to be applied towards the further reduction of State debt and other State liabilities.

3.8.43 **The costs incurred by the Department of Treasury and Finance and the VPC in relation to the sale totalled around $7 million. A substantial part of these costs related to the engagement of consultants and contractors to advise and assist in the sale process. As indicated earlier in this Report, in the main, these consultants and contractors were appointed following selective tendering or direct appointment processes, as the Department considered it impractical and inexpedient to undertake public tendering processes given the tight timeframe and circumstances associated with the sale.**

3.8.44 **In particular, audit identified that 8 appointments with individual contract values exceeding $50 000 having an aggregate estimated cost of $5.8 million (actual cost of $4.9 million) were made by the Department not using public tender processes but by using selective tendering or direct appointment processes.**

Key terms of sale arrangements

3.8.45 **Under the sale arrangements, the purchaser acquired a licence in perpetuity to manage around 166 000 hectares of plantation land forming part of the State's Crown land estate vested in the VPC, with a restriction placed on the purchaser to use this land only for the purposes of timber production, thereby facilitating the continued development of the plantation industry in Victoria.** In particular, the plantation licence issued to the purchaser under the *Victorian Plantations Corporation Act* 1993, confers on the purchaser the perpetual right to:

- establish, maintain and manage timber plantations on the licensed land; and
- take or convert forest produce on the licensed land.

3.8.46 An additional limited-term licence relating to the occupation, management and use of certain specified plantation land totalling around 1 600 hectares, covering the period up until 31 December 2010, was also acquired by the purchaser. Under this licence, following the final harvest of the forest produce on the licensed land, the purchaser must treat the land "to a sufficient extent to enable the successful seeding and re-establishment of native species indigenous to the general locality".

3.8.47 As the holder of the above plantation licences, the purchaser is required to comply with the Code of Forest Practices established under the *Conservation, Forests and Lands Act* 1987. The Code's aim is to ensure the careful stewardship and responsible management of all forestry activities. In particular, the Code regulates all private commercial timber growing and harvesting operations to ensure compatibility with the conservation of a wide range of environmental values associated with plantations. The responsibility for enforcing the requirements of the Code on private land and the Corporation's vested land rests with the respective local government authorities.

3.8.48 In relation to any possible land title claims, under the arrangements the State has retained responsibility for meeting any compensation which may be payable to any party "in relation to the passage of the *Victorian Plantations Act* 1993 and the *Land Titles Validation Act* 1993".

3.8.49 The VPC's obligations in relation to 3 supply agreements established under various legislation which were not successfully re-negotiated prior to sale, were assigned to the purchaser through individual *"back-to-back"* contracts, appended to the Forestry Services Agreement. Under these arrangements, the Corporation in effect sub-contracted the purchaser to perform its obligations to supply timber to customers under the existing terms and conditions of the original supply agreements. The VPC's commercial risk exposure under these arrangements was assessed by the Corporation as minimal as it has recourse against the purchaser in the event that its obligations have not been met.

3.8.50 The other significant terms and conditions of the arrangements are as follows:

- The Treasurer guaranteed the performance of the VPC's obligations under the Asset Sale Agreement;
- The VPC was required to conduct its business, up until the date of sale completion, in a manner which preserved the value of the assets and the financial and trading position of the business. However, the purchaser acknowledged that payments with an aggregate value of $33 million were to be made by the Corporation to the State prior to sale completion, mainly relating to dividends and tax equivalents payable for the period up to 30 November 1998;
- The exposure of the VPC and the State in relation to any claims made by the purchaser under the Asset Sale Agreement was limited to a nominal amount of $1;

- The purchaser provided an indemnity to the VPC and the State generally against any claim or liability for property damage or injury or death of any person which arises directly or indirectly out of negligence, a breach of contract or a breach of a statutory duty by the purchaser, including any claim arising from the pollution or contamination of the land or water; and
- The purchaser was required to engage all 120 full-time staff of the Corporation and to honour their leave entitlements.

3.8.51 Under the *Country Fire Authority Act* 1958, the purchaser and indeed other private sector plantation operators, are generally required to form fire industry brigades under the direction of the Country Fire Authority, where fire risks associated with the plantations are determined to be high. These brigades are required to be staffed and equipped by the owners or occupiers of the land with the aim of reducing the risk of fire escalation and ensuring a co-ordinated and efficient response to fire threats.

3.8.52 Consequently, with the formalisation of the above stated arrangements relating to the former VPC timber plantations, the statutory responsibility for fire prevention and suppression has been transferred from the VPC and the Department of Natural Resources and Environment to the purchaser and the Country Fire Authority. **Irrespective of these arrangements, the purchaser has no contractual redress against the VPC or the State generally for any financial losses incurred as a result of fire damage to its plantations.**

Impact of possible future "carbon credit" trading

3.8.53 As a result of international deliberations on environmental issues, in December 1997 a number of nations including Australia agreed in-principle to the implementation of a protocol under which emission levels of certain greenhouses gases into the atmosphere would be restricted within specified parameters. Under the protocol, the establishment of an "emissions trading system" was identified as a mechanism that could be utilised to enable participating nations to fulfil their commitments. If introduced, an emissions trading system would be based on the issue of permits that authorised the holder to emit a specified amount of greenhouse gases. Carbon "sinks", such as forestry plantations, could be incorporated into an emissions trading system by allocating credits for the amount of carbon stored within the plants, and ultimately, plantation operators could then trade these credits as a tradeable commodity within the international trading system.

3.8.54 The Australian Greenhouse Office is responsible for providing policy advice to the Commonwealth Government on the establishment of a national emissions trading system within Australia. It is anticipated that policy advice on a such a scheme will be provided to the Commonwealth Government by late 1999. Simultaneously, the Commonwealth Department of Foreign Affairs and Trade is participating in ongoing international negotiations to define the operation of an international trading system. However, as the Commonwealth is yet to make a decision on the establishment of a national emissions system, currently there is no mechanism which allows owners of forest plantations to trade in carbon credits. However, Commonwealth Government policy in this area is encouraging plantation development, with farmers aware that "carbon sinks" could become a valuable resource over the course of the next 10 years.

3.8.55 **In the context of these national and international developments, audit identified that while the State achieved a good result for the sale of the Victorian Plantations Corporation, the sale arrangements did not specifically provide for the sharing by the State of any financial benefits that could be derived by the purchaser from a future introduction of a carbon credit trading system. However, the Department advised that the purchaser would have taken account of the impact of this issue when determining their bid and, therefore, any associated perceived benefits would be reflected in the sale result achieved by the State.**

❒ ***RESPONSE*** *provided by Secretary, Department of Treasury and Finance*

The Department of Treasury and Finance believes that the sale of the Victorian Plantations Corporation (VPC) resulted in a very positive outcome for both the State and Victoria's timber industry.

Given the complexity of the corporatisation, renegotiation of supply contracts, and privatisation of the VPC, the Department would like to highlight the following achievements:

- *The sale price was $158 million to $201 million in excess of all previous valuations;*
- *A dividend (including tax equivalents) of $33 million was paid in addition to the sale price;*
- *Expenditure on advisers was $926 000 less than estimates and approvals;*
- *All VPC staff were employed by Hancock;*
- Exposure of the VPC and the State to claims under the asset sale agreement were limited to $1;
- *Wide-ranging indemnities from Hancock were obtained by the State;*
- *No redress for Hancock to either the VPC or the State for any financial losses incurred as a result of fire damage to its plantations*;
- *A demonstrated commitment from Hancock to maintain and develop the VPC's business and plantations.*

With regards to carbon credits, the sale was structured to allow for a single up-front payment, including any possible value associated with carbon credits.

Notwithstanding, it should be noted that:

- *There is no carbon credit regime in force;*
- *There is widespread international concern about the structure/value of any of the suggested carbon credit models; and*
- *Australia has not committed to join any carbon credit regime.*

SALE OF ALUMINIUM SMELTERS OF VICTORIA PTY LTD

3.8.56 Aluminium Smelters of Victoria Pty Ltd (Aluvic) was a wholly-owned company of the State through which the State held a 25 per cent joint venture interest in the Portland Aluminium Smelter, which is located on a 600 hectare site at Portland, around 375 kilometres west of Melbourne. Aluvic also held interests in the aerospace aluminium components industries located in France and in the United States of America.

3.8.57 The smelter's original design capacity, when fully commissioned in 1988, was 300 000 tonnes of aluminium per annum, however, with ongoing improvements in production processes and the availability of additional electricity, the smelter's production capacity was planned to reach approximately 312 000 tonnes per annum in the 1998 calender year. The smelter during the 1996-97 financial year produced 292 000 tonnes of aluminium.

Joint venture arrangements

3.8.58 In March 1979, Alcoa of Australia Ltd (Alcoa) announced its intention to establish an aluminium smelter at Portland which was considered to be a suitable location for such a facility, mainly due to its access to the existing deep water port facilities, its proximity to the Japanese and other Asian markets and the ability of the State Electricity Commission of Victoria (SECV) to supply electricity for the smelter's operation at prices which were sensitive to movements in world aluminium prices.

3.8.59 In July 1984, the Portland Smelter Joint Venture was established, with Alcoa and the State (the participants) taking a 60 per cent interest and a 40 per cent interest, respectively. The key arrangements associated with the operation of the joint venture included a participants' agreement and the smelter's electricity supply arrangements.

3.8.60 The participants' agreement outlined the participants' respective interests in the joint venture and imposed an obligation for financial contributions towards the capital and operating costs of the smelter in proportion with the participants' equity interest. The agreement also entitled each participant to a share of the aluminium produced by the smelter and required the parties to be individually responsible for the marketing and sale of their portion of the aluminium production. Furthermore, the agreement, which continues until July 2018, conferred pre-emption rights to the non-State participant(s) in the event of any transfer (sell-down) of the State's participating interest.

3.8.61 At the time of the establishment of the joint venture, the State's interest was held by the Portland Smelter Unit Trust, with Aluvic having responsibility for the management of the Trust. However, in January 1987, Aluvic became the trustee of the Trust and continued in this dual role of manager and trustee until July 1993 when Aluvic Services Pty Ltd, a wholly-owned subsidiary, became the trustee and Aluvic continued as the manager.

3.8.62 The issued units of the Trust were initially held by the Treasurer on behalf of the State and, from May 1990 to July 1994, these units were held by State Trustees Ltd on behalf of the State. However, in July 1994, Aluvic acquired all of the issued units of the Trust from State Trustees Ltd and issued shares in consideration. Finally, in a further stage of restructuring, in December 1995 the assets of the Trusts were transferred into Aluvic Metal Sales Pty Ltd, a wholly-owned subsidiary of Aluvic.

3.8.63 Subsequent to the establishment of the joint venture, the State's 40 per cent was reduced through the following sales:

- *January 1986* - sale of a 5 per cent interest in the smelter to First National Resource Trust, now known as Eastern Aluminium Ltd; and
- *September 1992* - sale of a further 10 per cent interest in the smelter to Marubeni Aluminium Australia Ltd, a company controlled by a Japanese-based organisation, Marubeni Corporation.

3.8.64 In addition, in 1986 Alcoa's 60 per cent interest in the smelter was reduced to 45 per cent through 2 sales. Consequently, immediately prior to the sale of the State's remaining 25 per cent interest in the joint venture, the equity ownership of the joint venture comprised:

- State interest via Aluvic Metal Sales Pty Ltd - 25 per cent interest;
- Alcoa - 45 per cent interest;
- CITIC Nominees Ltd, a wholly-owned subsidiary of the Beijing-based China International Trust and Investment Corporation - 10 per cent interest;
- Eastern Aluminium Ltd - 10 per cent interest (Aluvic held a 16 per cent shareholding in this company); and
- Marubeni Aluminium Australia Ltd - 10 per cent interest.

Electricity supply arrangements

3.8.65 My previous Reports to the Parliament have commented on the electricity supply arrangements for the Portland smelter which were established by the Government in 1984. Although these arrangements have positively impacted on the financial performance of the smelter, they have at the same time imposed a substantial financial burden on the State.

3.8.66 Under the arrangements, which extend to the year 2016, the SECV is required to supply a base electricity load of 520 megawatts for the production of aluminium at Portland. Similar arrangements exist for the supply of power to a smelter located at Point Henry, near Geelong, which is also controlled by Alcoa. These arrangements include a flexible electricity tariff agreement which requires the State to accept lower than acquisition prices charged for electricity supplied to the smelters when aluminium prices fall below a stipulated level, a situation that has occurred consistently in recent years. **Between the 1984-85 and 1997-98 financial years Victorian taxpayers ultimately paid $1.45 billion (Portland smelter - $1.04 billion, Point Henry smelter - $410 million) to the SECV to subsidise the lower prices charged for electricity supplied to the smelters.**

3.8.67 As at 30 June 1998, the Government's Annual Financial Statement disclosed that the estimated net present value of the State's liabilities under the flexible electricity tariff arrangements were $1.3 billion. However, these financial statements also disclosed an asset of $894 million, representing a future revenue stream funded by a *smelter reduction amount levy* payable by wholesale electricity market participants, mainly electricity distribution companies, which will be applied by the SECV in funding part of the liabilities under the flexible electricity tariff arrangements.

3.8.68 While additional power of 64 megawatts was provided annually to the Portland Smelter to maximise its production capacity, in January 1995 this supplementary supply was terminated by the State. The Government subsequently indicated that it was not prepared to negotiate for the supply of additional electricity to the smelter as Alcoa was reluctant to re-negotiate the terms of the agreements under which the substantial flexible electricity tariff payments were required to be made by the State. However, in September 1997, the Treasurer announced that the Government had reached an agreement with the joint venture participants for the provision of additional power to the smelter. The supplementary power arrangements provided for the supply of up to an additional 120 megawatts to the smelter from January 1998 to December 2002.

3.8.69 **The successful completion of the supplementary power arrangements removed what was considered by the Government to be a significant impediment to Aluvic's privatisation while, at the same time, had the effect of adding an estimated $47 million in value to Aluvic's 25 per cent interest in the joint venture.**

One of 4 pot-rooms at the Portland Smelter.
(Photo courtesy of ALUVIC.)

Sale process

3.8.70 In October 1997, the financial consultants of the Department of Treasury and Finance recommended a privatisation strategy for Aluvic which incorporated a trade sale process to be undertaken in parallel with the encouragement of the submission of proposals for a public float, in order to maximise competitive tension. However, it was recognised that consistent with the requirements of the participants' agreement associated with the operation of the joint venture, the sales strategy would be subject to the previously mentioned pre-emption entitlements of the participants.

3.8.71 The financial consultants also stated that:

- the State should not actively undertake any action designed to avoid the pre-emption rights as the potential delaying effects of litigation initiated by a dissatisfied participant may be damaging in the context of a possible public float;
- Aluvic's existing portfolio of foreign currency exchange arrangements should be offered as part of the sale as it could be seen to add value and encourage the perception that Aluvic's management are capable of adding value to the business by undertaking such activities; and
- while the privatisation of Aluvic would achieve an exit from the direct investment in the aluminium industry, the State would still be faced with continued exposures to the market prices for aluminium and electricity, although the latter would be mitigated by a hedge contract secured by the SECV for the purchase of electricity from the wholesale electricity market, equivalent to the load required for the smelter.

3.8.72 Consistent with the above advice, in December 1997, the Treasurer agreed to a dual trade sale and public float privatisation strategy, which was subsequently ratified by Cabinet in April 1998.

3.8.73 Following the process of identifying and contacting potential purchasers by the Department's financial consultants, which commenced in January 1998, those parties which expressed an interest in the purchase of Aluvic, its subsidiaries or their respective assets subsequently received an information memorandum. The prospective purchasers were advised that Aluvic's core asset was its 25 per cent interest in the Portland smelter and that the operating costs of the smelter, excluding alumina (a core raw material used in the production of aluminium) compared favourably with industry costs worldwide. The information memorandum also highlighted that:

- The electricity supply arrangements associated with the smelter's operations, which feature a flexible electricity tariff, provided a partial hedge against the cyclical aluminium market;
- Aluvic managed its commodity price risk and foreign exchange risk exposures through a series of futures and option contracts whose prices are based on or priced with reference to the "London Metal Exchange", and through foreign exchange hedging arrangements so as to achieve Australian dollar cash flow outcomes of a higher value with lower volatility compared with market outcomes;

- With minor alterations, the production capacity of the smelter could increase by around 40 000 tonnes per annum to 390 000 tonnes per annum and the cost of such additional capacity would be significantly below "greenfield" smelter costs. More extensive additions to the plant could also accommodate an expanded capacity to around 600 000 tonnes per annum; and
- Aluvic is developing relationships within Asian markets so that it is well placed to take advantage of any shifts to the Asian region in aerospace production by European and North American companies.

3.8.74 In May 1998, following the review of 9 indicative proposals from prospective buyers, the Department's financial consultants recommended the short-listing of 5 bidders for the trade sale of Aluvic. The Department subsequently received 2 final trade sale bids in August 1998, with both bids electing not to purchase Aluvic's foreign exchange hedge book.

3.8.75 In June 1998, the Treasurer entered into a sale process agreement with the participants of the joint venture, excluding Alcoa, which provided an opportunity for the participants to pre-empt the highest offer that the State was prepared to accept from either a trade buyer or a float process. Alcoa had expressed their verbal support to the Government for the sale process, however, had elected not to join the participants in this agreement as they were not interested in buying the asset at price levels that would be acceptable to the State. In the event of a trade sale, under the agreement the participants were to be given 15 days to accept the State's offer for the purchase of Aluvic at a price and based on conditions equal to those of the preferred bidder, and would be required to pay the State's costs of sale up to an amount of $8 million. Furthermore, in the event that the participants declined to pre-empt the highest offer, the State was able to proceed with the sale to the preferred bidder or proceed with a float without further impediments to the sale transaction.

3.8.76 In addition, the Treasurer agreed to allow the State to reimburse the expenses incurred by the preferred bidder for the preparation of their bid up to a maximum amount of $2 million. In the event that the participants exercised their pre-emption rights, this cost would be covered by the participants contribution to the State's costs of sale.

3.8.77 In conjunction with the trade sale process, a stockbroking firm acting on behalf of the Department was seeking indications of demand from about 20 institutional investors for a proposed float of Aluvic. However, the Department agreed not to proceed to a float of Aluvic as the reaction to this proposal was poor.

3.8.78 In August 1998, following an assessment of the 2 final bids received by the Department, the Treasurer approved subject to the exercise of the pre-emption rights by the participants, the trade sale of Aluvic to a consortium comprising Glencore International AG, a Swiss natural resources group, and Century Aluminium Company, a United States-based aluminium producer, for $484 million, with the State required to assume responsibility of Aluvic's portfolio of foreign exchange hedge contracts.

3.8.79 **However, following the lodgement by CITIC and Marubeni of an offer to pre-empt the bid submitted by the preferred bidder, the Treasurer on 21 August 1998 approved the sale of Aluvic to these parties and authorised the payment of up to $2 million to the previously preferred bidder in respect of their bid costs. The sale price for Aluvic to CITIC and Marubeni was $US293 million, which at the time was estimated at $502 million in Australian dollars.**

3.8.80 A private sector accounting firm was appointed by the Department prior to the sale, to perform the responsibilities of process auditor for the sale of Aluvic. The firm concluded that all bidders and pre-emption parties were accorded fair and equitable treatment and that the tenders were evaluated and ranked fairly against the agreed selection criteria.

Novation of Aluvic's foreign exchange hedge book

3.8.81 In June 1998, as the privatisation of Aluvic was gaining momentum, the Department was conscious of the significant negative value associated with Aluvic's foreign exchange hedging arrangements due to the decrease in the value of the Australian currency and, consequently, sought to explore alternatives to unwind the hedging arrangements. At that time, the following alternatives were under consideration:

- in the event of a public float of Aluvic, the foreign exchange position of the book could be novated to the Treasury Corporation of Victoria (TCV) and the float sale proceeds applied by the Department to meet the losses incurred by TCV as a result of terminating the associated contracts;
- under a trade sale scenario, the potential purchasers of Aluvic could be allowed to submit bids with or without the transfer of the foreign exchange hedging arrangements;
- the foreign exchange hedge book could be assigned to a bank, at a cost to the State reflecting some of the tax benefits that may accrue to the bank; and
- the foreign exchange hedge book could be novated to the SECV at market values, however, this alternative was considered as a contingency option only.

3.8.82 In July 1998, the Department's financial consultants estimated that the cost to the State for the closure of the foreign exchange hedge book was between $80 million to $90 million and that this cost was very sensitive to changes in market prices including foreign exchange rates, interest rates and aluminium prices. Shortly thereafter, the Treasurer agreed to allow TCV and the Department's financial consultants to provide estimates of the cost for the novation of the foreign exchange hedging arrangements. At the time, management of TCV advised the Department that the bank counterparties of the foreign exchange hedging arrangements may refuse to accept the novation of the contracts to the financial consultants.

3.8.83 Following a lack of interest by the bidders for the purchase of Aluvic to acquire the foreign exchange hedge book, and the submission from the Department's financial consultants and TCV for the novation of Aluvic's foreign exchange arrangements and its subsequent cost of closing, the Treasurer in early August 1998 agreed to novate the arrangements to the financial consultants, at a cost of $86.5 million subject to final adjustment for the actual cost of terminating these arrangements. While this estimate was more favourable than TCV's final indicative estimate of $88.4 million, due to subsequent movements in market prices the financial consultants advised the Department that the adjusted close-out amount would be $94.4 million.

3.8.84 However, due to the fact that a substantial number of the bank counterparties of the foreign exchange hedging arrangements refused to accept novation of the contracts to the financial consultants, the State resolved to also involve TCV in the settlement of this exposure. Consequently, in August 1998 the State paid $12.2 million to the Department's financial consultants as the adjusted close-out amount under the above-mentioned agreement and in September 1998 paid $89 million to TCV to facilitate the settlement of the remaining exposure.

Sale results

3.8.85 **Following the conversion of the sale proceeds to Australian dollars, the State received gross proceeds of $502 million. However, $109 million of this amount was directed towards meeting costs associated with the assumption and termination of the foreign exchange hedge book ($101 million) and the cost of sale ($8 million).**

3.8.86 Table 3.8D outlines the proceeds received from the sale of Aluvic and the proceeds in excess of the book value.

TABLE 3.8D
SALE PROCEEDS
($million)

Details	*Total*
Gross cash proceeds	**502**
Proceeds equal to the State's interest in the book value of the business	*(a)* 401
Proceeds in excess of book value	101

(a) Represents the State's interest in Aluvic's net assets as at the date of sale.

3.8.87 The above table discloses that the State received $502 million for the sale of the net assets of Aluvic, which at the effective date of sale had a book value of $404 million. In effect, this resulted in the State obtaining proceeds of $101 million in excess of the book value of the business. However, after taking account of an amount of $109 million which was applied from the proceeds by the State to fund the closure of Aluvic's foreign exchange hedge book and to meet the State's costs of sale, **the net loss to the State from the sale of Aluvic was $8 million** which is shown in Table 3.8E below. The costs associated with the closure of the foreign exchange hedge book resulted from the foreign exchange trading losses incurred by Aluvic which at the time of sale to the purchaser amounted to $101 million.

TABLE 3.8E
NET OUTCOME TO THE STATE
($million)

Details		*Total*
Proceeds in excess of book value		101
Less:		
Closure of foreign exchange hedge book (*a*)	101	
Costs of sale (*b*)	8	109
Net loss to the State		**8**

(a) Under the sale arrangements, the State retained responsibility for the cost of terminating Aluvic's foreign exchange hedge book.

(*b*) Represents the estimated costs of sale which included $2 million paid to the preferred bidder as a reimbursement of costs incurred in the preparation of its bid.

3.8.88 **In placing this result in context, it is important to recognise that the establishment of the supplementary power arrangements for the smelter which were established by the Government in September 1997, had the impact of increasing its operating capacity which increased Aluvic's value by around $47 million.**

3.8.89 **In addition, it should also be recognised that while the State has divested its interest in Aluvic, it has retained a related substantial financial exposure associated with the flexible electricity tariff arrangements which had an estimated net value of around $240 million related to its former 25 per cent interest in the Portland smelter.**

Business valuations

3.8.90 **The cash proceeds of $502 million received from the sale of the business compared favourably with the valuations of the business provided by the Government's financial consultants in July 1998 and immediately before the close of bids in August 1998, on the basis of a trade sale.**

3.8.91 In particular, the valuations received in July 1997, which included an estimated value for the foreign exchange hedge book of between $16 million and $29 million (based on a $0.75 exchange rate with the United States dollar) if all existing contract were closed-out, were summarised as follows:

- *$458 million to $469 million*, based on the provision of a base load of electricity to the smelter (520 megawatts) and a supplementary load of 100 megawatts; and
- *$411 million to $421 million*, based on the smelter operating with a base load of 520 megawatts.

3.8.92 The August 1997 valuations, which excluded a net cost of $80 million for the close-out of the foreign exchange hedge book, were as follows:

- *$342 million to $482 million*, based on a comparison with the share price of Eastern Aluminium Ltd;
- *$362 million to $422 million*, based on net present value of the estimated future cashflows of Aluvic's interest in the smelter; and
- *$416 million to $470 million*, based on a comparison with the price paid by Marubeni, in September 1992, for a 10 per cent interest in the joint venture.

Obligations of the purchaser

3.8.93 Under the sale arrangements, the purchasers of Aluvic agreed not to sell their respective interests in the joint venture acquired from the State, except with the prior written consent of the State, for a period of 2 years from the date of sale completion. In addition, the purchasers agreed not to wind-up Aluvic or its subsidiaries within 6 months of sale completion and to release the Treasurer from certain contractual obligations made in November 1997 which included a Treasurer's Guarantee to the other joint venture participants of Aluvic's obligations under the previously mentioned participants agreement and the provision of indemnities in relation to the electricity supply arrangements between the SECV and the operator of the Portland smelter.

Obligations of the State

3.8.94 As part of the sale arrangements, the State has provided certain general indemnities and warranties to the purchasers which give rise to a maximum exposure to the State of $7.5 million in the event that the purchasers lodge claims within 12 months from the date of sale. The State also provided an indemnity against any liability imposed on the purchasers to pay State equivalent taxation which was not fully provided for in the financial statements of Aluvic for the year ended 30 June 1998. However, in August 1998, the Treasurer directed that income tax not be levied on Aluvic under the State Income Tax Equivalent system for the period 1 July 1998 to 20 August 1998.

3.8.95 Furthermore, the State was required to novate each of the foreign exchange hedge contracts so that neither Aluvic or its subsidiaries be a party to any of them by the sale completion date. As previously mentioned, the State assumed these contracts at a cost of $101 million.

❒ ***RESPONSE*** *provided by Secretary, Department of Treasury and Finance*

The Report fails in 3 key areas to accurately reflect the Aluvic transactions:

- *The Report confuses the outcomes of the privatisation transaction, which resulted in an $8 million price improvement on the original sale agreement and proceeds of $101 million above book value, with the foreign exchange losses incurred by Aluvic. The costs associated with the closure of the foreign exchange hedge book resulted from trading losses incurred by Aluvic which at the time of sale to CITIC Marubeni amounted to $101 million. These losses arose as a result of Aluvic's FX trading activities and not as a result of the sale transaction;*
- *Despite audit having as its first review objective to examine "the basis of the government's decision to divest its interest in the smelter" the Report fails to reflect the Government's rationale for the sale. The sale of Aluvic has removed significant commercial risks to the State arising from exposure to world aluminium commodity price fluctuations and associated foreign exchange exposures as demonstrated by the losses of $101 million incurred by Aluvic up to the time of sale; and*
- *The conclusion reached in the Report may be read to incorrectly imply that the State, through the sale, has given up significant additional value associated with the supplementary power arrangements negotiated with Alcoa in September 1997. The benefit of this arrangement is already factored into the valuation of the asset. With respect to the conclusion reached on the flexible tariff arrangements this exposure is fully provided for in the accounts of SECV. The extent of this exposure has neither increased or decreased with the sale of Aluvic.*

GAS INDUSTRY REFORM

3.8.96 My previous Reports to the Parliament have commented on the status of the Government's extensive reform program for the gas industry. In summary, the *Gas Industry Act* 1994 was enacted to facilitate the disaggregation of the former Gas and Fuel Corporation of Victoria, through the transfer of the property, rights and liabilities associated with the gas distribution and retail business to GASCOR, and the transfer of the property, rights and liabilities associated with the transmission business to the Gas Transmission Corporation.

3.8.97 Further reforms were announced in March 1997, when the distribution and retail operations of GASCOR were unbundled into 3 "stapled" gas businesses, each comprising a gas retailer and a gas distributor. These businesses were established as separate legal entities in December 1997, with each gas retailer servicing a geographically defined customer base, as depicted in Table 3.8F below.

TABLE 3.8F
RETAIL COMPANIES - A SNAPSHOT

kinetik ENERGY	**Kinetik Energy** The company servicing approximately 398 000 customers, covering a distribution area including Melbourne's north-eastern and outer western suburbs, and western and north-central Victoria. This business is attached to the gas distributor known as Westar.
energy 21	**Energy 21** The company servicing the eastern Melbourne areas, the Mornington Peninsula, and northern and eastern Victoria. Energy 21 has the highest customer density, with approximately 517 000 customers. This business is attached to the gas distributor known as Stratus.
IKON	**Ikon Energy** The company servicing approximately 504 000 customers extending over inner western, central and south-eastern Melbourne. This business is attached to the gas distributor known as Multinet.

3.8.98 My previous Reports have also commented on other key elements of the reform process, including the establishment of a gas services company to provide centralised services to the new businesses, the separation of the ownership and management of the transmission assets, resulting in the establishment of Transmission Pipeline Australia Pty Ltd (TPA), and the creation of the Victorian Energy Networks Corporation (VENCorp) to assume the responsibility for system and market operating functions within the wholesale gas market.

Major developments during the 1998-99 financial year

Privatisation program

3.8.99 As has been mentioned in my previous Reports to the Parliament, in April 1998 the Government approved in principle the sale of the State-owned gas businesses, subject to their sale demonstrating as being of public benefit, the satisfactory preparation of the businesses for sale and the existence of appropriate market conditions at the time of sale. On this basis, the privatisation process was commenced with the issue to interested parties in May 1998 of an Information Memorandum for one of the "stapled" businesses, which resulted in the receipt of a number of indicative bids.

3.8.100 However, in May 1998, draft decisions on the proposed access arrangements for the gas industry were issued by the Office of the Regulator-General (ORG) which has responsibility for the regulation of the gas distribution businesses, and the Australian Competition and Consumer Commission (ACCC) which has responsibility for the regulation of TPA. The access arrangements set out the terms and conditions under which gas transmission and distribution services would be provided to users of the system, and the basis on which future prices would be determined by the respective regulators.

3.8.101 While the majority of decisions by the regulators were acceptable, the main concern of the Government was that the proposed arrangements required a reduction in the rates of return to be applied to set the regulated revenues of the gas distribution and transmission businesses. The regulators believed that the reduced rates of return more accurately reflected the appropriate cost of funds for these businesses. Pending the resolution of these matters and other associated issues with the regulators, the Treasurer in July 1998 publicly announced the deferral of further steps to introduce competition into the gas industry and the finalisation of the privatisation process

3.8.102 Subsequent to the consideration of submissions lodged by interested parties, a final decision on the Victorian access arrangements was issued by the regulators in October 1998, which required a rate of return of 7.75 per cent to be applied in setting the regulated revenues of the gas businesses, compared with a rate of 10.16 per cent proposed by the Government in relation to the "stapled" businesses. Following certain amendments to the access arrangements in November 1998 by the Department of Treasury and Finance, the regulators provided their final approval to the access arrangements in December 1998.

3.8.103 Given the finalisation of the access arrangements for the gas industry, the Government announced that it was proceeding with the privatisation of the State's gas businesses. Consequently, following a trade sale process, **in the period between January 1999 and March 1999, the Government announced the sale of the State's 3 "stapled" gas businesses which achieved gross proceeds in the order of $5.3 billion**. In March 1999, the Government also announced the sale of PIPEX, a business unit of Gas Business Services, for a price of $4.5 million and, at the date of preparation of this Report, the sale of Transmission Pipeline Australia Pty Ltd (TPA) was expected to occur in early May 1999.

3.8.104 **A comprehensive assessment of the gas business sales during the 1998-99 financial year is intended to be provided in my October 1999 *Report on the Victorian Government's Finances*.**

The Longford explosion - "The gas crisis"

3.8.105 Around 98 per cent of Victoria's natural gas has historically been sourced from the Gippsland Basin in Bass Strait and is supplied to GASCOR by ESSO and BHP (the producers) under a joint venture arrangement. Gas is transported from the off-shore fields through pipelines to a processing facility operated by ESSO at Longford, near Sale, in Victoria's south-east. The Longford facility consists of 3 gas processing plants and a crude oil stabilisation plant. Once the gas is processed at the Longford facility, it is transported by pipeline for sale to domestic, commercial and industrial consumers.

3.8.106 As a result of an explosion and fire, in September 1998 one of the Longford processing plants was extensively damaged, including systems and piping common to the remaining 2 gas processing plants. In order for the gas producer to isolate the damaged equipment, all 3 plants were shut down, resulting in a substantial reduction of gas flows to the State over a period of almost 3 weeks. The resumption of gas supply from the remaining 2 gas plants occurred in October 1998, however, ESSO's processing capabilities had been reduced by approximately one-third.

The September 1998 explosion and fire at the Longford processing plant.
(Photo courtesy of The Age.)

3.8.107 Given the substantial impact of the above incident across Victoria, in October 1998 the Premier announced the establishment of a Royal Commission into issues associated with the matter, with the findings of the Royal Commission expected to be available by June 1999.

3.8.108 **To minimise the likelihood of future disruptions to Victoria's gas supplies, the Government has undertaken a number of initiatives, including the acceleration of certain previously planned gas infrastructure projects to facilitate alternative sources of gas supply to assist in restoring gas supply security levels.**

Key initiatives to improve the gas supply

3.8.109 Given that the Victorian gas market has been dominated by a single gas producer (the ESSO and BHP joint venture), a primary objective of the gas reform program initiated by the Government in recent years, through the Department of Treasury and Finance, has been the development of gas transmission pipelines connecting the Victorian gas transmission system with the systems of neighbouring States. These developments would allow a diversity of sources of gas supply to flow into Victoria, and provide an opportunity to introduce competitive pricing into the Victorian gas industry. These developments include:

- *New South Wales Interconnect Pipeline* - involving an expansion of the 150 kilometre interconnect pipeline with New South Wales which was previously developed through a joint venture arrangement between Transmission Pipelines Australia Pty Ltd and East Australia Pipelines Ltd. Gas from this pipeline is made available from the Cooper Basin gas fields in New South Wales, which provide an alternative gas supply, and a market for the sale of Victorian gas to New South Wales. The first stage of the Interconnect Pipeline was commissioned in August 1998, with the expansion of the pipeline expected to be completed by mid June-1999;
- *South-West Pipeline* - involving the linkage of the State's existing gas transmission system to the Port Campbell gas fields and the South-West gas distribution system in south-west Victoria, through the earlier than anticipated construction of a new pipeline which has a projected completion date of May 1999. Together with the Port Campbell Underground Storage Project which is discussed below, this pipeline *inter alia* will:
    - extend the natural gas supply to new towns and cities situated between Geelong and Port Campbell and provide additional security of natural gas supplies to Warrnambool, Portland, Cobden and Hamilton by connecting to the Western transmission system in early 2000; and
    - promote further development of gas fields in the Otway Basin.
- Port Campbell Underground Gas Storage Project - which will connect with the South-West Pipeline and will provide underground reservoirs which can be filled with surplus gas during periods of low demand and can be supplied to the transmission system at times of high demand or in cases of supply emergency. This project is being developed by Texas Utilities Australia Pty Ltd under a build, own and operate (BOO) arrangement and will improve the security of the State's gas system security. An audit analysis of the arrangements associated with is project is proposed to be provided in my October 1999 Report on the Victorian Government's Finances.

3.8.110 Audit was advised that gas supply contracts for the operation of the expanded New South Wales Interconnect and South-West Pipelines have been negotiated by the Government.

3.8.111 As the above infrastructure development projects and the associated supply contracts alone may not be sufficient to meet peak period gas demand in the event that ESSO and BHP are unable to meet their contractual commitments, the Government has supported the development of gas management programs involving industrial and commercial customers, which are aimed at facilitating the establishment of dual fuel capabilities by these customers.

Commencement of the gas market

3.8.112 A key objective of the Government's gas reform program has been the introduction of contestability within the gas industry to achieve enhanced service outcomes in terms of both quality and price. Consequently, under the arrangements established for the operation of the gas market, retailers will not have a guaranteed customer base beyond September 2001 given that, as from that date, consumers will have choice regarding the retailer they wish to use for their purchase of gas.

3.8.113 A key feature of the new Victorian gas industry will be the operation of a wholesale "spot market" which will provide a mechanism by which market participants can trade, and thus influence, the price of gas. Under the arrangements, gas wholesalers and producers will be able to bid competitively for surplus production not committed under existing gas sales contracts. The creation of a wholesale spot market for gas is intended to:

- facilitate the further development of the gas transmission system on a market-related basis;
- facilitate infrastructure development and stimulate the development of gas fields in Victoria's off-shore and on-shore basins; and
- encourage the entry of new retailers into the gas market.

3.8.114 Notwithstanding the development of the spot market, it is expected that traditional long-term contracts will continue to play a major role in the gas market for some time. However, as the spot market will provide parties with greater commercial flexibility, these long-term contracts will become less significant. Market participants are not required to trade on the spot market, however, there are certain incentives for such participation. For instance, under the established industry rules, in return for funding pipeline extensions, market participants will receive an enforceable right to transport gas which may be subsequently traded on the market.

3.8.115 An "operational trial" of the gas market commenced in July 1998 to enable participants to become familiar with the mechanics of the market rules and to identify any problems in software and market design. Due to delays in the finalisation of the regulatory instruments which give effect to market operations and the completion of appropriate commissioning tests, the commencement of the market was delayed from September 1998 to March 1999.

Gas supply agreement

3.8.116 Under the Gas Supply Agreement between GASCOR and ESSO and BHP, which covers the vast majority of Victoria's gas requirements, GASCOR is responsible for the purchase of gas for its ultimate on-selling to customers. A comprehensive analysis of the agreement, which will remain in operation until December 2009, was provided in my May 1997 *Report on Ministerial Portfolios*. Exclusive agency agreements have been entered into with the individual gas retailers for the sale of gas on behalf of GASCOR to industrial and domestic gas consumers within specific franchise areas, with these agreements to lapse once full contestability for the sale of gas occurs in September 2001. Under these agreements, the retailers receive commission from GASCOR for gas sales achieved.

3.8.117 In addition, GASCOR has entered into sub-sales agreements with each retailer to enable the retailers to meet the gas requirements of its contestable customers, in so far as those requirements can be met by gas sourced under the Gas Supply Agreement, with commission on such sales also to be paid to the retailers.

SALE OF BENTLEIGH SITE BY GASCOR

Aerial view of the Bentleigh site.

3.8.118 Under the Government's reform program for the gas industry, GASCOR retained certain assets which were regarded as surplus to the Government's requirements, including a site located at the corner of Thomas Street and Brewer Road, Bentleigh, which was acquired in the late 1970s. The site to be sold occupied a total area of 5.2 hectares and contained a woollen mill complex which had been developed in the late 1930s.

3.8.119 An environmental assessment of the site, commissioned by GASCOR and undertaken in December 1997, concluded that the site contained several isolated areas of contamination. It was subsequently estimated that the required remediation works would cost between $450 000 to $750 000 and that the cost to demolish the existing buildings would be in the order of $1.1 million. These costs were to be met by the purchaser of the site with the State not retaining any related obligations.

3.8.120 In April 1998, the Valuer-General estimated the value of the property at $6.9 million and concluded that the best alternative use for the site would be for residential purposes. However, a private valuer in May 1998 provided a lower valuation of $6.6 million. On the basis of the above valuations, GASCOR determined a reserve price of $6.9 million for the sale of the property.

Sale process

3.8.121 Following a request for public tenders for the acquisition of the site in May 1998, GASCOR received 12 conforming bids ranging from $5.2 million to $11.5 million in nominal terms, proposing various settlement periods, and 11 expressions of interest with bids ranging from $3.5 million to $10.4 million in nominal terms.

3.8.122 Following an assessment of the bids received, GASCOR selected a successful bidder, who offered a purchase price of $10.5 million in nominal terms. Subsequently, the bidder was advised of this outcome, however, at this time another bidder Becton Corporation Pty Ltd (Becton) approached GASCOR and subsequently increased its original offer to $11.55 million.

3.8.123 As a consequence of the new offer by Becton, GASCOR received legal advice in order to determine the legality of accepting the revised offer. The legal advice subsequently received indicated that GASCOR could accept the new higher offer, or proceed to a secondary tender process involving the 2 parties. Subsequently, the 2 parties were invited to submit revised offers with a preferred settlement period of 6 months.

3.8.124 On the closing of this tender process, Becton offered a revised bid of $11.65 million with a 6 month settlement. The other party also submitted a revised offer of $11.56 million with a settlement period of 6 months, but advised GASCOR of the following concerns in relation to the sale process:

- GASCOR's initial acceptance of its tender was considered to give rise to a contract between the parties;
- the secondary tender process was considered improper and in breach of its contract with GASCOR; and
- unless it received written notice that GASCOR would proceed with the sale of the site in its favour, it would seek redress to enforce its legal rights against GASCOR.

3.8.125 In response, GASCOR subsequently advised that no offer for the sale of the site had been formally accepted by this party and consequently no contractual relationship existed between GASCOR and this party. At the time of preparation of this Report, no claims had been made against GASCOR in relation to this matter.

3.8.126 **In late May 1998, GASCOR advised Becton that its amended offer of $11.65 million with a 6 month settlement period had been accepted.**

Assessment of sale result

3.8.127 **An analysis of the sale result concluded that:**

- **the sale proceeds of $11.65 million were $4.8 million higher than the property valuation of $6.9 million provided by the Valuer-General in April 1998;**
- **the sale proceeds were $5.2 million higher than GASCOR's book value for the property; and**
- **after taking account of the costs of approximately $153 000 incurred in relation to the sale, the net proceeds of the sale were $11.5 million.**

❒ ***RESPONSE*** *provided by General Manager - Special Projects, GASCOR*

GASCOR accepts the findings of the review.

FINANCIAL STANDING OF WORKCOVER

3.8.128 The Auditor-General's May 1998 *Report on Ministerial Portfolios* included comment on the financial standing of the WorkCover scheme which is managed by the Victorian WorkCover Authority. That Report highlighted that while the Government's key financial objective was to maintain the scheme's fully-funded position which was achieved in past financial years, since July 1997 the financial position had deteriorated with the scheme no longer being fully-funded.

3.8.129 Table 3.8G which outlines the financial position of the scheme for the period 30 June 1997 to 31 December 1998 discloses that **the proportion of the scheme's net assets in relation to its outstanding claims liability as at 31 December 1998 was 96 per cent, an improvement of 3.8 per cent from the funding ratio recorded 12 months earlier of 92.2 per cent.**

TABLE 3.8G
FINANCIAL POSITION OF THE WORKCOVER SCHEME,
30 JUNE 1997 TO 31 DECEMBER 1998
($million)

	30 June 1997	*31 Dec. 1997*	*30 June 1998*	*31 Dec. 1998*
Premium revenue	938	438	960	580
Investment revenue	617	131	437	250
Claims expenditure	1 445	779	1 350	748
Operating profit before income tax and abnormal items	**(51)**	*(a)* **(296)**	**(123)**	*(a)* **(14)**
Outstanding claims liability *(b)*	3 445	3 737	3 859	4 069
Net assets	**3 449**	**3 445**	**3 709**	**3 905**
Surplus assets / (Deficiency)	4	(292)	(150)	(164)
Funding level (per cent)	**100.1**	**92.2**	**96.1**	**96.0**
Return on investments (per cent)	**21.5**	**3.8**	**12.9**	**6.4**

(a) For the 6 month period ended 31 December 1997 and 1998.
(*b*) Represents net present value.

3.8.130 As mentioned in the previous Report, the scheme's funding deficiency as at 31 December 1997 was mainly caused by the following factors:

- an increase in the number of common law writs lodged, higher average settlements for such cases and the maturity of the new common law system;
- the impact of changes in the economic assumptions utilised by the actuary such as inflation rates and investment earnings; and
- an increase in the duration of benefit payments made to claimants, with 75 per cent of the outstanding claims liability extending beyond 2 years.

3.8.131 The negative financial position has persisted despite the introduction of legislative amendments in November 1997 which had the effect of eliminating the recovery of common law damages for work-related injuries that occurred on or after 12 November 1997. According to actuarial advice obtained in December 1998, the result reflects the fact that the majority of the scheme's outstanding claims liability still relates to claims incurred prior to these changes.

3.8.132 The scheme's funding deficiency has been mainly due to a significant increase in the payment of common law damages and related legal payments as a consequence of a rise in the projected number of common law settlements which totalled 7 100 for the 6 month period ending 31 December 1998, representing a 30 per cent increase on that estimated in the actuarial review as at 30 June 1998. As a consequence, this component of the outstanding claims liability increased from $564 million as at 30 June 1998 to $735 million as at 31 December 1998. In addition, the outstanding claims liability has increased due to further changes in the economic assumptions applied by the actuary, especially the impact of an additional reduction in interest rates.

3.8.133 However, the increase in the outstanding claims liability was to an extent offset by strong investment earnings attributable to the domestic and international equity markets and additional premium income reflecting an increase in the premium rate, the inclusion of employee superannuation payments in the determination of the remuneration base for premium calculation purposes and strong growth in the labour market.

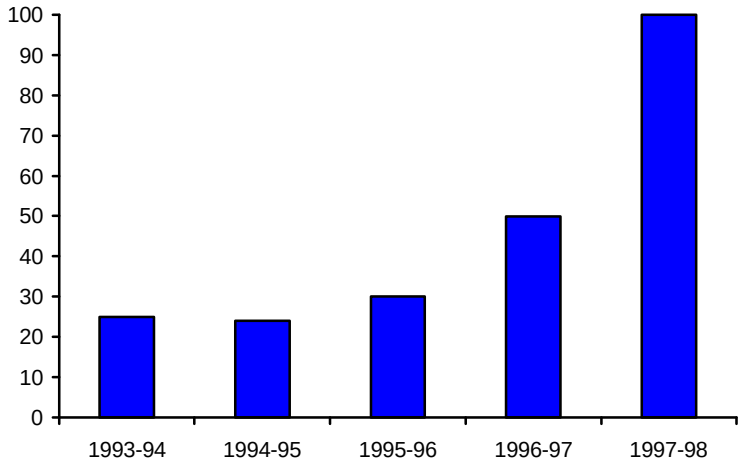
3.8.134 The actuarial estimate of the outstanding claims liability as at 31 December 1998 has not taken into account issues relating to the proposed taxation reforms of the Commonwealth Government relating to the goods and services tax.

3.8.135 In respect of the actuarial estimate for 31 December 1997, the Authority was advised that the ongoing cost of the scheme after the abovementioned legislative changes would be equivalent to 1.71 per cent of wages, which meant that there was a significant positive margin when compared with the actual premium rate of 1.9 per cent. As a result of higher rehabilitation and other costs, the ongoing cost of the scheme has increased to 1.73 per cent as at 31 December 1998. The Authority's actuary is of the view that the positive margin of 0.17 per cent will result in a gradual improvement in the funding position over time, which is expected to reach 100 per cent by December 2000. However, the actuary also indicated that *"if interest rates remain at current low levels, premium income over the short-term will be invested at rates lower than the* [assumed future investment rate] *of 6.5 per cent and the funding ratio will take longer to reach 100 per cent"*.

Actuarial assessment of the level of outstanding claims

3.8.136 Since the inception of the scheme, the estimate of its outstanding claims liability has been independently assessed by 2 actuaries on a half-yearly basis. The higher, more conservative of the 2 valuations as at 30 June of each financial year is then incorporated in the Authority's annual financial statements. Chart 3.8H illustrates the magnitude of the variances in the outstanding claims liability assessments by the independent actuaries for the financial years 1993-94 to 1997-98, which ranged from a variance of $24 million as at 30 June 1995 to $100 million at 30 June 1998, representing 2.6 per cent of the outstanding claims liability as at that date. **While the variance is not material when compared with the outstanding claims liability, it does have a material impact on the Authority's operating result.**

CHART 3.8H
VARIANCES IN OUTSTANDING CLAIMS LIABILITY ASSESSMENTS, 1993-94 TO 1997-98
($million)



3.8.137 The Authority's Board agreed, effective from December 1998, to no longer use 2 actuaries and adopt the more conservative of the 2 valuations for accountability purposes, but will only utilise one actuarial firm to assess the level of the scheme's outstanding claims liability and engage another firm to perform a peer review of the actuarial valuation. The Authority's Board's rationale for the change is as follows:

- the scheme is in a more stable position, in part because of legislative revisions, compared with the previous WorkCare scheme;
- claims experience is now more predictable;
- the scheme has consolidated around the full-funding position;
- the Authority has its own internal actuarial models which are used for valuations and monitoring of claims liabilities; and
- the Authority also engages external actuarial consultants from time-to-time, to review the scheme's performance.

3.8.138 The Authority's outstanding claims liability is subject to various economic and non-economic factors which have a significant impact on the actuarial valuation. The use by the Authority in the past of 2 actuaries and the recognition of the higher assessed liability figure has provided the necessary additional assurance to the users of the Authority's financial statements that the liability is reasonably stated. In addition, audit has difficulty supporting the changed approach by the Authority's Board due to the significant variances in the 2 actuarial assessments as outlined in the above chart.

3.8.139 **It is audit's view that due to the magnitude of the outstanding claims liability and the sensitivity of the scheme, the Authority should continue to have the outstanding claims liability valued each half-year by 2 independent external actuaries and recognise the higher assessed value in the body of its financial statements.**

National Competition Policy review of the WorkCover legislation

3.8.140 As outlined in the Auditor-General's May 1998 *Report on Ministerial Portfolios*, in January 1998 the Department of Treasury and Finance Legislative Review Steering Committee released its final report in relation to the National Competition Policy Legislative Review on the Workplace Accident Compensation Legislation. Essentially, the final report concluded that the objectives of the legislation could be achieved through private sector underwriting of the scheme and that this would enhance rather than threaten effective injury prevention and rehabilitation from work-related injury.

3.8.141 In March 1998, the Authority submitted its summary response to the recommendations of the Review Panel and concluded that it did not support a privately underwritten workers' compensation system. The Authority raised the following factors in support of its view:

- the pricing clarity of the existing premium system could be damaged and lead to sub-optimal outcomes for injury prevention and return to work activity;
- the cost to employers is unlikely to decline due to the complexity of mechanisms required to support private underwriting;

- the maintenance of a single comprehensive database by the Authority may be jeopardised by private underwriters wishing to use their own disparate information systems;
- private insurance companies will be motivated to offload long-term claimants to the government-funded welfare system;
- injury prevention may be negatively affected by severing the link between health and safety and insurance;
- small employers may be subjected to higher levels of premium volatility; and
- service providers who are unable to meet capital requirements may be precluded from entry to the market, thereby limiting competition.

3.8.142 In October 1998, after considering submissions made by the Authority and other stakeholders, and the performance of the scheme over the past 5.5 years, the Government publicly announced that it had not accepted the proposals of the Review Panel. The Treasurer and the Minister for Finance stated that they were satisfied that the scheme was delivering fair outcomes to victims of workplace accidents, while operating on a sound commercial basis to ensure the ongoing viability of the scheme. The Minister also stated that Victorian employers paid the lowest premiums for workers' compensation coverage in Australia and there was insufficient reason to hand responsibility of underwriting to private interests. The following key reasons were provided in support of the Government's view:

- The integration of occupational health and safety regulation with centralised price setting and the Authority's underwriting role, provided the opportunity for the scheme to directly link regulatory practices with financial incentives;
- The integration of the scheme allows for a centralised database which aids in the identification of trends and enables the Authority to more accurately assess the performance of the scheme which is paramount as workers' compensation schemes are dynamic and potentially volatile;
- The Authority's premium setting is based on individual employers' workplace performance and not general occurrences in the entire insurance market. Although the Government expressed the view that it is intended to maintain a centralised approach to premium setting, it will introduce greater flexibility to enable the Authority's insurance agents to compete on administrative costs;
- The Victorian workers' compensation system prior to 1985 which was a privately underwritten scheme, failed to deal with accident prevention, rehabilitation and return to work of injured workers; and
- The previous WorkCare scheme had problems with controlling costs since its inception with unfunded outstanding liabilities peaking at over $4 billion. However, since 1992 the current scheme has seen a dramatic turnaround in performance.

3.8.143 The Government also advised that the Authority should retain both its monitoring and approval functions with a focus on outcomes in relation to the delivery and quality of service of the insurance agents, self-insurers and occupational rehabilitation providers, as the ability to affect behaviour through the current approval process is much more effective than only having a monitoring role which could impose penalties to encourage satisfactory outcomes.

3.8.144 As a result of the Government's decision, amendments were made to the *Accident Compensation Act* 1995 which were enacted in November 1998. The objective of the legislative amendments was to promote greater competition in the scheme by reinforcing the Authority's role as the sole insurer but allowing risk management and claims management services to be provided by agents who need not be insurance companies. The legislative changes are to be effective from July 1999.

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

Actuarial assessment of the level of outstanding claims

Since the inception of WorkCover, the scheme's claims liability has been independently valued by 2 actuaries every 6 months. In August 1998, the Authority's Board decided to move to one independent actuarial valuation every 6 months.

In considering the objective for the scheme of full-funding, as referred to in the Auditor-General's Report, it is the Authority's view that the full year cost of 2 valuations is not justified in light of:

- *the small average variation between the 2 actuarial valuations of 1.6 per cent over the last 3 years;*
- *enhanced in-house capacity to actuarially assess financial performance of the system and to confirm external actuarial results;*
- *practice in other jurisdictions (e.g. NSW, SA and Qld), where only one actuarial assessment is conducted; and*
- *as a result of the maturing of the scheme and legislative changes, liabilities and emerging costs are less volatile.*

In this context, the following words in the Report may be misleading "The Authority's Board agreed, effective from 2 December 1998, to no longer use 2 actuaries and adopt the more conservative of the 2 valuations for accountability purposes, but will utilise one actuarial firm to assess the level of the scheme's outstanding claims liability and engage another firm to perform a peer review of the actuarial valuation". In fact, the Authority in making its decision on the utilisation of actuaries, considered a range of criteria including that of accountability. The Authority concluded that accountability requirements were fully met under the new arrangements to appoint one actuary with peer review.

While the Authority is moving from a more conservative approach the current approach is not required by accounting standards and the use of 2 actuaries is not standard practice in other similar systems in Australia, the TAC or the private insurance industry.

UPDATE ON PLAYER FAIRNESS ISSUES IN THE GAMING INDUSTRY

3.8.145 My March 1998 Special Report No. 54 on Victoria's Gaming Industry documented the results of a performance audit of the Victorian Casino and Gaming Authority.

3.8.146 The audit examined the manner in which the Authority discharged its regulatory responsibilities dealing with the State's gaming industry. The key conclusion reached in the Report was that an effective regulator is overseeing the day-to-day workings of a major Victorian industry.

3.8.147 In my report, I raised a number of important issues relating to player fairness. I concluded that players of gaming machines have a *"right to know"* a range of basic information and that this right was of such significance that it warranted further assessment by the Authority of its official regulatory approach to the concept of player fairness.

3.8.148 In view of the overall significance of the issues and because over 12 months have elapsed since the tabling of my Report in the Parliament, I decided to seek from the Authority details of any actions it had taken in the intervening period on the particular player fairness matters addressed in the Report.

3.8.149 I have presented below a description of the various issues together with the advice furnished to me by the Authority on the current status of the matters.

Multiple levels of player returns in respect of the same game

3.8.150 On this matter, I advised that it was normal practice for gaming operators and the casino operator to apply for, and receive, the Authority's approval to utilise at their discretion multiple versions of the same game with each version having a different level of return-to-player percentage. The various return percentages approved by the Authority for different versions of the same game typically range between the 87 per cent minimum statutory return level and 95 per cent or more, and must be adhered to when the particular versions are in use.

3.8.151 I recognised in my Report that the use of return-to-player percentages above the statutory minimum directly benefited players. However, I considered that the lack of player awareness of these circumstances effectively denies a player the opportunity of making an informed choice of which venue to visit or which machine to play, given that different return rates could apply from time-to-time to versions of the same game within a venue.

3.8.152 The basic premise of my comments was that in this era of competition, gaming operators and the casino operator should be obligated to publish the average return rates which would apply to their machines at particular venues over a period so that patrons could shop around and make an informed choice on which venue to visit and which game to play. Such an arrangement would be no different to the position of most other suppliers of products or services where the availability of data on prices and quality of service etc. is used by purchasers to select a supplier. Currently, gaming patrons are denied such a facility and are essentially distanced from the ongoing commercial decisions of operators. As I saw it, the principle of player fairness demanded that patrons have access to this fundamental information.

3.8.153 I therefore recommended to the Authority that information available to players of gaming machines within a gaming venue or the casino should include sufficient details to enable players to be aware of the average return-to-player percentages applicable to games in use at that venue, including any differences in percentages in respect of the same game.

Player returns below the statutory minimum during certain phases of metamorphic games

3.8.154 On this issue, I advised that the commonly-used *metamorphic* games on gaming machines feature the accumulation of bonus tokens or signs as games are played. Such games generate a bonus phase such as free games when a particular number of such tokens or signs has been accumulated. For most games within this category, the likely return-to-player percentage prior to the bonus phase can be well below the statutory minimum level of 87 per cent. The statutory level or, if applicable, a higher level is reached after the bonus phase is completed.

3.8.155 In a metamorphic game examined during the 1998 performance audit, it was found that a large proportion of the overall player return percentage was derived from the so-called “bonus” phase of the game and the return percentage in the lead-up to this phase was only around 72 per cent. In effect, players received no real bonuses and the bonus phase was simply an element of the game cycle which brought the player return to the minimum statutory level.

3.8.156 Drawing on the principle of player fairness, I recommended that the Authority ensure the 87 per cent statutory minimum return to players is enforced for all pre-bonus phases of metamorphic games. In this way, any bonus derived from the metamorphic character of a game should, in line with the literal meaning of the word “bonus”, take the form of a return over and above the minimum level of return.

Complicated rules of some games

3.8.157 Under this heading, I informed Parliament that the rules of many games within gaming machines are technologically complex and difficult to understand. I acknowledged that perfect clarity to players is sometimes difficult to achieve because of such complexity. However, I concluded the position was not entirely satisfactory, particularly from the viewpoint of novice or uninitiated players who often would find it hard to comprehend the rules of games in terms of the extent of progressive payouts and what steps to follow at particular stages of a game.

3.8.158 My recommendation to the Authority was that the presentation of game rules, whether involving artwork or specific information in game menus, be in such a form that all players, experienced or otherwise, can always readily understand.

Information on winning chances not available to players

3.8.159 With this issue, I explained that, unlike most other forms of gambling, information on approximate winning odds is generally not available to players of gaming machines. All relevant information is effectively quarantined from players as it resides within game software which cannot be accessed by players.

3.8.160 I advised Parliament that information on winning chances could be readily summarised and tabulated in a form which presented to players in a simple manner each individual prize and the odds of winning that prize over the full cycle of a game. Such data could be made available to players in this simple tabulated form within a special menu on gaming machines. As an illustration to Parliament, I stated that data relating to a number of games was analysed and tabulated during the performance audit and showed the odds of winning the top prizes in these games ranged between 9.8 million and 12.1 million to one.

3.8.161 There was no doubt from my viewpoint that this important matter required specific attention by the Authority as part of its regulatory role.

The TABCORP gaming venue, Highways at Sandown.
(Reproduced with the permission of TABCORP.)

The formulation of a players' charter

3.8.162 My overall conclusion from consideration of the above player fairness issues was players of gaming machines have a "right to know" a range of fundamental information without which they are basically *gambling in the dark*. My final recommendation to the Authority was the formulation of a players' charter which would articulate the whole gamut of information deemed as essential to players in order that their position in terms of fairness is totally assured.

3.8.163 I considered the Authority to be the appropriate body to drive the development and dissemination within the industry of such a charter.

3.8.164 If a players' charter was introduced, players would be in a position to reach a more informed choice about where to gamble and which machines to play, based on available data. Such action would assist players in making responsible decisions about their gambling activities i.e. it would directly complement the encouragement of responsible gambling.

3.8.165 If a players' charter was introduced, players would be in a position to reach a more informed choice about where to gamble and which machines to play, based on available data. Such action would assist players in making responsible decisions about their gambling activities i.e. it would directly complement the encouragement of responsible gambling.

3.8.166 Subsequent to my March 1998 Report to Parliament, the Public Accounts and Estimates Committee specifically endorsed my call for a players' charter for the gaming industry in its November 1998 report to Parliament on the 1998-99 Budget Estimates.

Response received from the Authority on the current status of the above player fairness issues

3.8.167 The Authority's Director of Gaming and Betting recently provided the following update in response to my request for details of any developments or actions which have occurred at both local and national levels on the above matters since my earlier Report to Parliament:

"Consultation has occurred with other regulators, gaming machine manufacturers, testing laboratories, the gaming machine operators and the casino operator on each of your recommendations in respect of player fairness issues.

"An examination is also underway into information which might assist players to make an informed choice in respect of their gaming machine play and whether the Authority has statutory powers to mandate the provision of that information.

"These matters will be put to the Board of the Authority in due course."

My final comment on player fairness issues

3.8.168 The comments provided by the Authority indicate that consultation is occurring on a wide scale within the industry on the identified player fairness matters. The Authority is also examining its own legislative position in terms of the subject.

3.8.169 As I stated in my March 1998 Report to the Parliament, the right of players to know a range of basic information was of such significance that it warranted re-assessment by the Authority of its official regulatory approach to the concept of player fairness. From the response provided by the Authority, this re-assessment is currently in course.

3.8.170 I also indicated that any action which results in enhanced player awareness of such a fundamental aspect of the State's gaming environment would serve to further reinforce public confidence in the industry, a position directly complementary to the regulatory role of the Authority.

3.8.171 With gambling taxes the fourth highest source of government revenue derived within the State, I consider the most pressing issue now is that a timely outcome is achieved on this major question of player fairness in the gaming industry. In this regard, the Government, in consultation with the Authority, should establish a firm timeframe for finalising consideration of each identified player fairness issue and for the taking of action to better meet the needs of players.

SCHEDULE A
STATUS OF MATTERS RAISED IN PREVIOUS REPORTS

Report	*Subject*	*Status at date of preparation of this Report*
	MATTERS RESOLVED OR ACTION COMMENCED	
STATE ELECTRICITY COMMISSION OF VICTORIA		
Ministerial Portfolios, May 1998, *pp. 239-48.*	In May 1997, the State Electricity Commission of Victoria (SECV) terminated an external contract associated with the demolition and clearance of the former Yallourn power station complex due to inter alia, disputes with the contractor relating to the performance of its obligations.	The disputes were settled by mediation in August 1998, with no material financial impact on the SECV. The Administrator of the SECV appointed another contractor in February 1998 for the completion of the works within 2 years, at a cost to the SECV of $23.4 million.
DEPARTMENT OF TREASURY AND FINANCE		
Ministerial Portfolios, May 1997, *pp. 287-96.*	At the time of the introduction of the Corporate Card, the Department of Treasury and Finance did not develop a targeted level of cost savings to be achieved, nor has it since sought to establish the actual level of savings achieved within the Victorian public sector to ensure that optimum outcomes have been obtained from the utilisation of the Card. An audit analysis indicated that the Corporate Card was not widely used, when compared with the level of purchasing activity undertaken within the public sector. Consequently, available cost savings were not being fully realised. There was a need to strengthen the authorisation and verification procedures to ensure the probity and accountability of all corporate card payments.	Further comment in relation to the Corporate Card is included in this Report.

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

Report	*Subject*	*Status at date of preparation of this Report*
	MATTERS RESOLVED OR ACTION COMMENCED - *continued*	
DEPARTMENT OF TREASURY AND FINANCE - *continued*		
Ministerial Portfolios, May 1998, *pp. 277-84.*	While acknowledging that recent refurbishment and upgrading of certain city precinct properties have reduced the risk of short-term building deterioration and reduction of service potential, high priority should be given to the development of a costed and comprehensive longer-term preventative maintenance program for those State-owned properties which are to be retained.	During 1998, building services management plans and cyclical maintenance plans were prepared for the Government-owned office portfolio. The plans are being progressively implemented on a priority basis.
	In September 1995, it was estimated that rental savings arising from the implementation of the Government's City Precinct Strategic Plan would progressively increase to $32 million per annum by the 1999-2000 financial year compared with 1992-93 financial year rental levels, but in July 1996 the rental savings target was revised to $22 million per annum.	Accommodation requirements and consequential rental savings targets have been reviewed within each Government department and the revised target as at 31 March 1999 was $27.5 million per annum by 1999-2000. The increase in the target is due to continued favourable rental conditions and some reduced area requirements within departments.
	The average space allocation per public servant remains excessive based on the target established by the Government.	The first full audit of city precinct office accommodation across departments identified that the overall average occupation was 17.9 square metres per full time equivalent, allowing for exemptions of non-office space categories (eg ministerial, library, public waiting areas). The Government's space target of 15 square metres per full time equivalent has been confirmed. Several departments have achieved or have come very close to achieving the standard, though further work is required within certain departments. The overall occupation rate is considered by the Department of Treasury and Finance to be acceptable.

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

Report	*Subject*	*Status at date of preparation of this Report*
	NO ACTION TAKEN	
DEPARTMENT OF TREASURY AND FINANCE		
Ministerial Portfolios, May 1996, p. 335.	There is a need for clarification within the Government's supply guidelines of the classification of consultancy and contractor services, in order to improve the disclosure of consultancy payments to the Parliament.	The Victorian Government Purchasing Board reviewed the classification of consultancy and contractor services within the supply guidelines, however, the Board decided against amending the guidelines.

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 Treasury and Finance	30 June 1998	31 Oct. *Financial Management Act* 1994, s.46.	3 Sept. 1998	3 Sept. 1998
FINANCE				
Emergency Services Superannuation Scheme	30 June 1998	" "	16 Sept. 1998	22 Sept. 1998
Hospitals Superannuation Board	30 June 1998	" "	23 Sept. 1998	30 Sept. 1998
" "	1 July 1998 to 31 Dec. 1998	" "	24 Mar. 1999	29 Mar. 1999 *(a)*
Local Authorities Superannuation Board	30 June 1998	" "	25 Sept. 1998	7 Oct. 1998 *(a)*
Parliamentary Contributory Superannuation Fund	30 June 1998	" "	6 Oct. 1998	7 Oct. 1998
Regulator-General, Office of the	30 June 1998	" "	14 Sept. 1998	29 Sept. 1998
State Superannuation Fund	30 June 1998	" "	21 Sept. 1998	21 Sept. 1998
Victorian Superannuation Board	30 June 1998	" "	21 Sept. 1998	21 Sept. 1998
Victorian Superannuation Fund	30 June 1998	" "	21 Sept. 1998	21 Sept. 1998
Victorian WorkCover Authority	30 June 1998	" "	28 Aug. 1998	28 Aug. 1998
Water Industry Superannuation Fund	30 June 1998	" "	23 Sept. 1998	23 Sept. 1998
Water Industry Superannuation Fund Pty Ltd	30 June 1998	31 Oct. *Financial Management Act* 1994, s.53A.	23 Sept. 1998	23 Sept. 1998

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*		
GAMING				
Tattersall Gaming Machine Division	30 June 1998	31 Oct. *Gaming Machine Control Act* 1991, s.132.	28 Oct. 1998	30 Oct. 1998
Tattersall Sweep Consultation	30 June 1998	*Tattersall Sweep Consultation Act* 1958.	28 Oct. 1998	30 Oct. 1998
Tattersall's Club Keno	30 June 1998	31 Oct. *Club Keno Act* 1993, s.10.	28 Oct. 1998	30 Oct. 1998
Victorian Casino and Gaming Authority	30 June 1998	31 Oct. *Financial Management Act* 1994, s.46.	29 Sept. 1998	29 Sept. 1998
TREASURER				
A.C.N. 007 092 328 Limited *(b)*	30 June 1998	31 Oct. *Financial Management Act* 1994, s.53A.	21 Aug. 1998	21 Aug. 1998
Aluminium Smelters of Victoria Pty Ltd	30 June 1998	" "	29 July 1998	4 Aug. 1998
Aluvic Metal Sales Pty Ltd	30 June 1998	" "	30 July 1998	4 Aug. 1998
Australian Power Exchange Pty Ltd	30 June 1998	" "	13 Aug. 1998	7 Sept. 1998
" "	Period 1 July 1998 to 31 Mar. 1999	" "	26 April 1999	4 May 1999 *(c)*
Chief Electrical Inspector, Office of the	30 June 1998	31 Oct. *Financial Management Act* 1994, s.46.	19 Aug. 1998	26 Aug. 1998
Ecogen Energy Ltd	30 June 1998	31 Oct. *Financial Management Act* 1994, s.53A.	17 Mar. 1999	24 Mar. 1999
Energy 21 Pty Ltd	Period 26 June 1997 to 30 June 1998	" "	10 Sept. 1998	10 Sept. 1998
Gas Safety, Office of	30 June 1998	31 Oct. *Financial Management Act* 1994, s.46.	24 Aug. 1998	27 Aug. 1998
Gas services business Pty Ltd	Period 26 June 1997 to 30 June 1998	31 Oct. *Financial Management Act* 1994, s.53A.	27 Aug. 1998	1 Sept. 1998

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*		
TREASURER - *continued*				
Gas Transmission Corporation	30 June 1998	31 Oct. *Financial Management Act* 1994, s.46.	27 Aug. 1998	2 Sept. 1998
GASCOR	30 June 1998	" "	28 Aug. 1998	2 Sept. 1998
Gascor Holdings No. 1 Pty Ltd	Period 26 June 1997 to 30 June 1998	31 Oct. *Financial Management Act* 1994, s.53A.	28 Aug. 1998	9 Sept. 1998
Gascor Holdings No. 2 Pty Ltd	Period 30 June 1997 to 30 June 1998	" "	26 Aug. 1998	3 Sept. 1998
Gascor Holdings No. 3 Pty Ltd	Period 30 June 1997 to 30 June 1998	" "	10 Sept. 1998	10 Sept. 1998
Gasmart (Vic) Pty Ltd	Period 26 June 1997 to 30 June 1998	" "	24 July 1998	14 Aug. 1998
Generation Victoria	30 June 1998	31 Oct. *Financial Management Act* 1994, s.46.	26 Aug. 1998	28 Aug. 1998
Holding Trust *(d)*	Period 1 July 1997 to 29 June 1998	" "	21 Aug. 1998	21 Aug. 1998
Hastings Port (Holding) Corporation	30 June 1998	" "	8 Oct. 1998	13 Oct. 1998
Ikon Energy Pty Ltd	Period 26 June 1997 to 30 June 1998	31 Oct. *Financial Management Act* 1994, s.53A.	28 Aug. 1998	9 Sept. 1998
Kinetik Energy Pty Ltd	Period 26 June 1997 to 30 June 1998	" "	26 Aug. 1998	3 Sept. 1998
Loy Yang B Power Station Pty Ltd *(e)*	30 June 1998	" "	4 Sept. 1998	7 Sept. 1998

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*		
TREASURER - *continued*				
Melbourne Port Corporation	30 June 1998	31 Oct. *Financial Management Act* 1994, s.46.	11 Sept. 1998	14 Sept. 1998
Multinet (Assets) Pty Ltd	Period 26 June 1997 to 30 June 1998	31 Oct. *Financial Management Act* 1994, s.53A.	28 Aug. 1998	9 Sept. 1998
Multinet Gas Pty Ltd	Period 26 June 1997 to 30 June 1998	" "	28 Aug. 1998	9 Sept. 1998
National Power Exchange Pty Ltd	30 June 1998	" "	13 Aug. 1998	7 Sept. 1998
" "	Period 1 July 1998 to 31 March 1999	" "	26 April 1999	4 May 1999 *(c)*
Opalwood Pty Ltd	30 June 1998	" "	21 Aug. 1998	21 Aug. 1998
Port of Geelong Authority *(f)*	Period 1 July 1997 to 10 Dec. 1997	31 Oct. *Financial Management Act* 1994, s.46.	19 Oct. 1998	21 Oct. 1998
Port of Melbourne Authority *(f)*	Period 1 July 1997 to 10 Dec. 1997	" "	19 Oct. 1998	21 Oct. 1998
Port of Portland Authority *(f)*	Period 1 July 1997 to 10 Dec. 1997	" "	19 Oct. 1998	21 Oct. 1998
Power Net Victoria *(g)*	30 June 1998	31 Oct. *Financial Management Act* 1994, s.53A.	30 June 1998	6 July 1998
Quiet Life Limited *(e)*	30 June 1998	" "	4 Sept. 1998	7 Sept. 1998
Rural Finance Corporation	30 June 1998	31 Oct. *Financial Management Act* 1994, s.46.	5 Aug. 1998	5 Aug. 1998

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*		
TREASURER - *continued*				
Securities Finance Corporation Ltd	31 Dec. 1998	30 April. *Financial Management Act* 1994, s.53A.	3 Mar. 1999	3 Mar. 1999
Southern Hydro Ltd *(h)*	Period 1 July 1997 to 18 Dec. 1997	18 April. *Financial Management Act* 1994, s.53A.	24 Sept. 1998	28 Sept. 1998
Southgate Trust	30 June 1998	" "	21 Aug. 1998	21 Aug. 1998
State Electricity Commission of Victoria	30 June 1998	31 Oct. *Financial Management Act* 1994, s.46.	24 Sept. 1998	25 Sept. 1998
State Trustees Ltd	30 June 1998	31 Oct. *Financial Management Act* 1994, s.53A.	16 Sept. 1998	25 Sept. 1998
STL Financial Services Ltd	30 June 1998	" "	16 Sept. 1998	25 Sept. 1998
Stratus Networks Pty Ltd	Period 26 June 1997 to 30 June 1998	" "	10 Sept. 1998	10 Sept. 1998
Stratus Networks (Assets) Pty Ltd	Period 26 June 1997 to 30 June 1998	" "	10 Sept. 1998	10 Sept. 1998
TAC Law Pty Ltd	Period 27 Oct. 1997 to 30 June 1998	" "	20 Aug. 1998	21 Aug. 1998
Terec Limited *(e) (j)*	30 June 1998	" "	22 Oct. 1998	26 Oct. 1998
The Albury Gas Company Ltd	30 June 1998	" "	10 Sept. 1998	10 Sept. 1998
Transmission Pipelines Australia Pty Ltd	Period 26 June 1997 to 30 June 1998	" "	20 Aug. 1998	26 Aug. 1998

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*		
TREASURER *- continued*				
Transmission Pipelines Australia (Assets) Pty Ltd	Period 30 June 1997 to 30 June 1998	31 Oct. *Financial Management Act* 1994, s.53A.	20 Aug. 1998	26 Aug. 1998
Transmission Pipelines Australia (Holdings) Pty Ltd	Period 30 June 1997 to 30 June 1998	" "	20 Aug. 1998	26 Aug. 1998
Transport Accident Commission	30 June 1998	31 Oct. *Financial Management Act* 1994, s.46.	27 Aug. 1998	27 Aug. 1998
Treasury Corporation of Victoria	30 June 1998	" "	14 Sept. 1998	14 Sept. 1998
Tricontinental Australia Ltd	31 Dec. 1998	30 April. *Financial Management Act* 1994, s.53A.	3 Mar. 1999	3 Mar. 1999
Tricontinental Corporation Ltd	31 Dec. 1998	" "	3 Mar. 1999	3 Mar. 1999
Tricontinental Holdings Ltd	31 Dec. 1998	" "	3 Mar. 1999	3 Mar. 1999
Twin Waters Resort Pty Ltd	31 Dec. 1998	" "	3 Mar. 1999	3 Mar. 1999
Vicfleet Pty Ltd	30 June 1998	31 Oct. *Financial Management Act* 1994, s.53A.	6 Oct. 1998	22 Oct. 1998
Victorian Channels Authority	30 June 1998	31 Oct. *Financial Management Act* 1994, s.46.	29 Sept. 1998	1 Oct. 1998 *(i)*
Victorian Electricity Metering Pty Ltd *(e)*	Period 17 July 1997 to 30 June 1998	31 Oct. *Financial Management Act* 1994, s.53A.	4 Sept. 1998	7 Sept. 1998
Victorian Energy Networks Corporation	30 June 1998	31 Oct. *Financial Management Act* 1994, s.46.	10 Sept. 1998	16 Sept. 1998
Victorian Funds Management Corporation	30 June 1998	" "	27 Aug. 1998	27 Aug. 1998
Victorian Managed Insurance Authority	30 June 1998	" "	7 Sept. 1998	7 Sept. 1998

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*				
TREASURER - *continued*				
Victorian Power Exchange Pty Ltd	30 June 1998	31 Oct. *Financial Management Act* 1994, s.53A.	10 Sept. 1998	16 Sept. 1998
Victorian Rail Track	30 June 1998	31 Oct. *Financial Management Act* 1994, s.46.	28 Sept. 1998	28 Sept. 1998
V/Line Freight Corporation	30 June 1998	" "	20 Sept. 1998	20 Sept. 1998
Westar Pty Ltd	Period 26 June 1997 to 30 June 1998	31 Oct. *Financial Management Act* 1994, s.53A.	26 Aug. 1998	3 Sept. 1998
Westar (Assets) Pty Ltd	Period 26 June 1997 to 30 June 1998	" "	26 Aug. 1998	3 Sept. 1998
INCOMPLETE AUDITS				
GAMING				
Totalizator Agency Board	1 Aug. 1994 to 2 June 1995	31 Oct. *Financial Management Act* 1994, s.46.	Awaiting signed set of financial statements.	

(a) Final audits, as entities now come under the authority of the *Commonwealth Superannuation Industry (Supervision) Act* 1993.
(b) Formerly known as Southgate Control Limited. Name changed on 29 June 1998.
(c) Final audit. Entity sold to private sector on 31 March 1999.
(d) Final audit. Entity dissolved 29 June 1998.
(e) Company deregistered in April 1999.
(f) Final audit. Entity dissolved 10 December 1997.
(g) Final audit. Entity abolished 1 July 1998.
(h) Audit requested by the Treasurer of Victoria as at the date of sale of the entity's net assets to the private sector.
(i) Qualified audit report issued.
(j) Formerly known as Southern Hydro Ltd.

Part 4

Broad Scope Issues

Part 4

Broad scope issues

KEY FINDINGS

Corporate card - follow-up

- Given the sensitivity associated with the use of Corporate Cards by government agencies, it is disappointing that, at the date of preparation of this Report, the related guidelines had not been strengthened to address the issues previously identified by audit.

  Paras 4.1.1 to 4.1.6

Year 2000 issue

- The key initiatives established by the Government have provided a major focus on the Year 2000 issue and have raised Year 2000 awareness among the public and private sectors.

  Paras 4.2.9 to 4.2.11

- The Reports prepared by the Government's Year 2000 Risk Management Unit indicate that, as at 12 April 1999, public sector agencies were 92 per cent complete in achieving Year 2000 readiness by 30 June 1999, excluding the preparation of contingency plans. However, the audit examination of the public sector's progress towards achieving Year 2000 readiness has concluded that a major part of the total effort required to complete Year 2000 activities was yet to be undertaken.

  Paras 4.2.12 to 4.2.47

- As at 12 April 1999, around $296 million or 56 per cent of the estimated cost of the Year 2000 compliance program, was yet to be expended.

  Paras 4.2.18 to 4.2.21

- The audit found that contingency plans had not been completed for at least 7 090 critical systems and/or processes, which represent 27 per cent of total critical systems and/or processes. In addition, the status of contingency plans for a further 11 640 critical systems and/or processes was unable to be ascertained from the data held by the Year 2000 Unit.

  Paras 4.2.48 to 4.2.53

- Audit also identified that a risk assessment of the critical business processes and systems had not been undertaken to identify those which represent the greatest risk to the State as a whole.

  Paras 4.2.28 to 4.2.31

Part 4.1

Corporate card - follow-up

CORPORATE CARD - CENTRAL POLICY FRAMEWORK

4.1.1 The Auditor-General's May 1997 *Report on Ministerial Portfolios* outlined the results of an audit review of the use of Government Corporate Cards by a number of agencies within the public sector. Since the tabling of that Report, this matter has been the subject of significant public and parliamentary interest. The key findings included in that Report were that:

- Several instances were identified where Card transactions had not been independently approved, cardholders had not confirmed the receipt of related goods and services, and transactions were not supported by adequate documentation. Consequently, it was difficult to determine whether such expenditure was in fact incurred for official purposes;
- There was a need at the Departments of Justice, and Premier and Cabinet to strengthen the authorisation and verification procedures to ensure the probity and accountability of all Card payments;
- Almost 1 000 Cards had not been cancelled for up to 12 months after respective public sector agencies had been sold or abolished, unnecessarily exposing the State to financial risks;
- At the time of the introduction of the Card, the Department of Treasury and Finance had not developed a targeted level of cost savings to be achieved from the use of the Card, nor had it since sought to establish the actual level of savings achieved within the Victorian public sector to ensure that optimum outcomes were obtained from the utilisation of the Card;
- Based on the results of an audit analysis, the Card was not widely used when compared with the level of purchasing activity undertaken within the public sector. Consequently, available cost savings were not being fully realised; and
- The absence of central monitoring of Card utilisation adversely impacted on the ability of the Department of Treasury and Finance, as the responsible central agency, to measure and evaluate the success of the implementation of the Card across the whole-of-government, and to formulate strategies to promote its use and maximise any available savings.

4.1.2 The May 1998 *Report on Ministerial Portfolios* provided the following comments on the status of certain of the above findings, based on advice received from the relevant government departments:

- Department of Justice:
  - relevant policies were reviewed and management were informed of their obligations in relation to transaction authorisation and the need to maintain a satisfactory audit trail;
  - internal audit of Card management was conducted; and
  - business units were requested to review their Card holdings to ensure that Cards were held by appropriate staff and that credit limits were appropriate.

- Department of Premier and Cabinet:
  - reviewed and re-issued the acknowledgment form for Card recipients which contains specific guidelines on usage, with the revised form signed by all existing cardholders;
  - comprehensive guidelines on the use of the Card were being developed, which would advise on staff who should have an entitlement to a Card, how the Card should be used, the responsibilities of users and accountability requirements; and
  - internal procedures had been reviewed and now required the monthly Card statement to be authorised by the cardholder and countersigned by another financial delegate to indicate that the transactions are valid for business purposes and are approved for payment.

- Department of Treasury and Finance:
  - the Card facility was now centrally monitored, with such monitoring including a review, among other things, of total Card usage under the facility, Card usage by the master billing account holders, the appropriateness of bank charges and the selective questioning of large "cash equivalent" usage with the respective participants;
  - the Department played a leading role in the Victorian Government Best Practice Corporate Card Processing System Working Group which was established to:
    - implement a best practice Card purchasing transactions process framework across the whole-of-government; and
    - identify and provide a common Card system solution according to the best practice Corporate Card process framework while still meeting the specific needs of each government department;
  - the above Working Group intended to develop and implement a common streamlined process for Card purchases that reduces the cost of purchasing transactions and increases the usage of Cards across the Victorian government sector; and

- the Department ensured that any Cards that were on issue prior to the privatisation or abolishment of an agency were withdrawn from circulation by the event date, and are cancelled and returned to the bank by the account holder.

Recent developments

4.1.3 In late 1998, the Auditor-General was requested by the Department of Treasury and Finance to provide comment on certain proposed amendments to the government guidelines governing the use of the Card within the public sector.

4.1.4 **At the time of preparation of this Report, the Department of Treasury and Finance had not released revised guidelines for the use of the Corporate Card. Consequently, clear policy direction, in the form of revised guidelines, has not been reinforced by the Government or provided in response to matters previously raised by audit, and the strong public interest shown in this area over recent times.**

The use of Government Corporate Cards remains an issue of significant parliamentary and public interest.

4.1.5 **Key issues previously raised by audit that could be reinforced or addressed in revised guidelines include:**

- ***Documentation, verification and approval*** - All Card transactions must be adequately documented, verified by the cardholder and approved by another delegated officer;
- ***Rationalise existing guidelines*** - There is a need to rationalise existing guidance and other legislative requirements that currently exist in connection with the use of the Card. The impetus to rationalise existing guidelines arises from the volume of guidelines in existence and the consequential risk and uncertainty that may arise as to which of the existing guidelines prevails. Existing guidelines include Directions of the Minister for Finance under the *Financial Management Act* 1994, the Financial Management Regulations, the Supply Policy and Guidelines issued by the Victorian Government Purchasing Board, guidelines issued by the Department of Treasury and Finance (including the former Department of Finance) and guidelines issued by individual agencies;
- ***Use of the Card for private or personal expenditure*** - The Department of Treasury and Finance should reinforce and clarify the Government's policy position in the guidelines concerning the use of the Card for private or personal expenditure. In addition, some broad guidance should be provided as to what comprises private or personal expenditure. Guidance in this area could refer to the use of the Card for restaurant meals, alcohol, duty free purchases, gifts and staff functions;
- ***Cost-efficiency*** - The guidelines should provide assistance to agencies in identifying those particular circumstances under which the Card would represent the most cost-efficient purchasing tool. Consequently, the Card's usage should be aimed at achieving cost-efficiency while maintaining adequate accountability and control. Agencies could also be required under the guidelines to conduct their own analysis to identify those transaction types which provide the greatest cost savings from the use of the Card;
- ***Delegations*** - All Cardholders should have delegated authority to spend using the Card and this should be outlined in the guidelines;
- ***Spending limits*** - The current Card does not have a transaction spending limit; rather, it has a monthly credit limit. Delegations and guidelines need to reinforce the importance of transaction spending limits;
- ***Eligibility to be a cardholder*** - The guidelines should contain a clear policy position in respect of who is eligible and not eligible to hold a Corporate Card. It is currently possible for an agency to issue the Card to a person outside the public sector under a Deed of Variation of the Card Contract issued by the Victorian Government Purchasing Board;

- ***Risk management*** - Agencies should be required to establish procedures to adequately manage risks associated with the use of the Card, including procedures which:
  - detect idle or other Cards that should be withdrawn; and
  - ensure that all transactions are within each cardholders' delegated authority, verified, supported by adequate documentation and appropriately approved; and

- ***Role of the Department of Treasury and Finance*** - The Department's role could be expressly and formally extended to include the monitoring of the Card's utilisation across the whole-of-government in order to:
  - evaluate the ongoing success of the implementation and use of the Card;
  - continuously develop strategies to promote the Card's use and benefits;
  - maximise any available savings (including establishing, or encouraging agencies to establish a targeted level of savings against which to judge performance); and
  - ensure compliance with the Department's and the Minister's own policies and guidelines.

4.1.6 **Given the sensitivity associated with the use of Corporate Cards by government agencies, it is disappointing that, at the date of preparation of this Report, the related guidelines had not been strengthened to address the issues previously identified by audit. In the light of this situation, I concluded there was nothing more to be gained in conducting a further review of Corporate Card expenditure.**

❒ ***RESPONSE*** *provided by Secretary, Department of Treasury and Finance*

Spending limits

The current Card has both a transaction spending limit and a monthly credit limit. It is the responsibility of each agency to determine what the individual transaction spending limits will be.

Electronic bank authorisation on both limits occurs through eftpos terminals. The bank rejects any unauthorised manual transaction which exceeds the merchant's floor limit when the paper transaction is presented for processing.

Part 4.2

Year 2000 issue

THE PREPAREDNESS OF THE VICTORIAN PUBLIC SECTOR FOR THE YEAR 2000 ISSUE

4.2.1 The Auditor-General's previous 2 *Reports on Ministerial Portfolios* have commented on the Year 2000 issue which confronts all organisations that rely on information technology systems and equipment with electronic chips which have date functionality, such as lifts, security systems, telephone systems and medical equipment. Organisations can also be detrimentally effected by non-Year 2000 compliant suppliers through the impaired delivery of goods or services.

4.2.2 The Year 2000 issue relates to the capacity of the relevant systems and equipment to cope with the change of dates from the year 1999 to 2000. The issue potentially threatens all services on which the Victorian public has come to rely, including:

- emergency services, such as fire brigades and ambulances;
- law enforcement, including the Victorian Police's ability to respond to emergencies;
- health services provided by hospitals and municipal councils;
- public transport services; and
- electricity and gas supplies.

4.2.3 The previous Reports to the Parliament identified that none of the non-budget sector agencies that were reviewed by audit at that time were Year 2000 compliant and certain agencies had not begun remediating or replacing non-Year 2000 compliant systems and equipment, which exposed those organisations to the risk that their businesses may be detrimentally affected as a result.

Electronic chips within computers which have date functionality potentially pose a Year 2000 threat.

4.2.4 In November 1998, the Victorian Parliament's Public Accounts and Estimates Committee tabled its Report No. 26 in the Parliament, titled *Information Technology and the Year 2000 Problem - Is the Victorian Public Sector Ready?*. In that report, the Committee concluded that the public sector's response to the Year 2000 issue was slow, which was initially due to a lack of awareness about the nature and scope of the problem, and the view that it was the responsibility of each agency's information technology (IT) department alone to manage. Nevertheless, the Committee also reported that most agencies had given appropriate priority and corporate support to addressing the Year 2000 issue and had developed detailed compliance plans.

4.2.5 While the Committee also formed the view that the Year 2000 issue was well understood at the corporate level across the Victorian public sector and by the staff involved in addressing the Year 2000 issue, the Committee reported that many government agencies were unaware of the following important Year 2000 issues:

- the need for a clear 12 months in which to rigorously test and remedy problems that may be found in new IT systems and application programs;
- the need to develop contingency plans and update disaster recovery plans for all modified IT business-critical systems;
- the capacity of non-compliant embedded chip technology to affect important environmental and production control functions, such as heat and cooling or plant control; and
- programming errors in modified systems may require sustained Year 2000 compliance activities that may well extend into the Year 2000.

4.2.6 From a whole-of-government perspective, the Committee believed that there was a need for the Victorian public sector to:

- establish government-wide priorities to remediate systems, based on such criteria as the potential for adverse effects on health and safety, business continuity, security and the economy;
- develop a comprehensive understanding of the State's Year 2000 readiness;
- develop Year 2000-related disaster relief planning in the possible event of multiple and concurrent failures in essential services such as telecommunications and utilities, i.e. electricity, gas, water and sewage;
- raise the community's awareness of the Year 2000 issue by reporting on associated problems, and provide the required assurances that action is being taken to address these issues;
- develop, in conjunction with the Commonwealth Government, new initiatives to ensure small to medium-sized enterprises undertake contingency planning;
- seek assurances from third parties that any interfacing data systems are Year 2000 compliant, with agencies also needing to address this potential risk exposure in their contingency plans; and
- encourage major utility companies and public corporations to share information and co-ordinate their individual Year 2000 compliance programs in order to ensure Year 2000 compliance is achieved in essential services.

4.2.7 At the date of preparation of this Report, the Government had not issued a formal response to the Committee's Report.

4.2.8 In recognition of the many initiatives within the public sector to address the Year 2000 issue, and in light of the fast approaching deadline, my Office conducted a review of the Government's central monitoring arrangements with the objective to reporting to the Parliament on the progress made by public sector agencies in achieving Year 2000 compliance.

Key government initiatives to address the Year 2000 issue

4.2.9 The Government's overall objective for the Year 2000 compliance program is to achieve the continued and unimpaired delivery of services to the public and business community beyond 31 December 1999. The Government had originally set a deadline of 31 December 1998 to achieve Year 2000 compliance of all business critical systems and processes within the public sector. However, in March 1999, Cabinet revised the deadline for achieving Year 2000 readiness to 30 June 1999.

4.2.10 **Key government initiatives to address the Year 2000 issue have included:**

- **Establishment of an Emergency Response Task Force to consider potential emergency situations which may arise during critical Year 2000 dates. The State's Disaster Plan (DISPLAN) is also being updated to incorporate contingency plans developed by the Task Force, and strategies have been developed with the aim of ensuring that adequate manpower and resources are available to address potential emergencies as they arise;**
- **Establishment of the Year 2000 Risk Management Unit (the Year 2000 Unit) within the department of Treasury and Finance to monitor the progress of each department and agency in achieving Year 2000 compliance. The Year 2000 Unit provides monthly reports to government Ministers on the readiness of all public sector agencies to achieve Year 2000 compliance. Further comment on the Unit is included later in this Report;**
- **Introduction of the Victorian "Good Samaritan Bill" in the Parliament, which aims to alleviate concerns about legal action being taken against organisations which provide information and assurances to other organisations in connection with their preparedness for the Year 2000 issue. The Bill, which was enacted on 11 May 1999, encourages businesses and other organisations to co-operate through the exchange of information about their Year 2000 preparedness and related activities;**
- **Provision of information by the Department of State Development, the WorkCover Authority and the Commonwealth Government to private sector organisations to ensure they are aware of the potential impact of the Year 2000 issue on their operations. In addition, the Commonwealth Government has established the Year 2000 Project Office, developed a national strategy and made $520 million available in tax concessions for business software expenditure; and**
- **Establishment of a panel of consultants by the Victorian Government Purchasing Board, which are capable of supporting Year 2000 risk management activities at public sector agencies.**

4.2.11 The key accountabilities associated with the Year 2000 issue, which were established or clarified at the time of creation of the Government's Year 2000 Unit included:

- The Minister for Finance became responsible for Year 2000 compliance across all public sector agencies;
- The Minister for Emergency Services became responsible for the formulation of a comprehensive Year 2000 contingency plan, and ensuring that all agencies have appropriate arrangements in place to meet their obligations under the *Emergency Management Act* 1986, particularly with respect to addressing the State Emergency Response Plan;
- The Minister for Industry, Science and Technology became responsible for the Government's private sector Year 2000 awareness campaign;
- All Ministers became accountable for Year 2000 compliance and contingency planning for all agencies within their portfolio;

- Agencies became responsible for managing projects to address the risks associated with the Year 2000 issue, and ensuring the ongoing delivery of their programs and services;
- Each Minister and department required to detail the progress achieved on the Year 2000 issue in their annual reports; and
- Ministers, departmental secretaries and the most senior representative of each agency required to sign-off on their Year 2000 preparedness as part of the final phase of the Year 2000 program.

OVERALL AUDIT ASSESSMENT

4.2.12 The Government has set the deadline of 30 June 1999 for all Victorian public sector agencies to obtain Year 2000 compliance of all business-critical systems and processes to ensure that the public sector provides uninterrupted delivery of products and services to the Victorian public and business community beyond 31 December 1999. The key initiatives established by the Government have provided a major focus on the Year 2000 issue and have raised Year 2000 awareness among the public and private sectors.

4.2.13 All public sector agencies have formal Year 2000 programs in place and are making progress towards achieving Year 2000 readiness. As part of the Year 2000 program, 26 560 business systems and/or processes within the Victorian public sector have been identified as at 12 April 1999 as critical to the delivery of services, representing a significant decease over the previous month.

4.2.14 **The total cost to the State of Year 2000 activities has been estimated to be in excess of $526 million, including approximately $179 million for the upgrade of information technology systems that had previously been included in expenditure plans for future years, which will now be brought forward and expended in the current year.**

4.2.15 The Reports prepared by the Government's Year 2000 Risk Management Unit indicate that, as at 12 April 1999, public sector agencies were 92 per cent complete in achieving Year 2000 readiness by 30 June 1999, excluding the preparation of contingency plans. The Unit also reported that contingency plans had been completed for around 72 per cent of identified critical systems and/or processes as at that date.

OVERALL AUDIT ASSESSMENT - *continued*

4.2.16 **However, the audit examination of the public sector's progress towards achieving Year 2000 readiness by 30 June 1999 has concluded that a major part of the total effort required to complete Year 2000 activities was yet to be undertaken.** The key considerations underpinning this conclusion included:

- As at 12 April 1999, around $296 million or 56 per cent of the estimated cost of the Year 2000 compliance program, was yet to be expended. In order to achieve the Government's target date of 30 June 1999 for the completion of the State's Year 2000 activities, this amount will need to be expended in an 11 week period; and
- An analysis of data held by the Year 2000 Unit as at 12 April 1999 revealed that:
  - At total of 1 770 systems and/or processes, representing 7 per cent of the State's critical systems and/or processes, had not been assessed for Year 2000 compliance status or for the possible impact of the failure of these systems on service delivery;
  - Remediation action plans had not been prepared for at least 4 250 critical systems and/or processes, representing 16 per cent of the total critical systems and/or processes. In addition, the status of remediation action plans for a further 4 160 critical systems and/or processes was unable to be ascertained from the data held by the Year 2000 Unit;
  - Remedial and Year 2000 compliance testing activities had not been completed for at least 10 620 critical systems and/or processes, representing 40 per cent of total critical systems and/or processes. In addition, the status of remedial and compliance testing activities for a further 6 355 critical systems and/or processes was unable to be ascertained. According to information technology industry sources remediation of systems can take up to 40 to 60 per cent of the total effort to complete Year 2000 activities. In addition, the Parliament's Public Accounts and Estimates Committee found in its recent Report on *Information Technology and the Year 2000 Problem - Is the Victorian Public Sector Ready?* that there is a need for a clear 12 months in which to rigorously test and remedy problems that may be found in new information technology systems and application programs. Accordingly, remediation and compliance testing activities are not an inconsequential element of the total Year 2000 project; and
  - Contingency plans have not been completed for at least 7 090 critical systems and/or processes, which represent 27 per cent of total critical systems and/or processes. In addition, the status of contingency plans for a further 11 640 critical systems and/or processes was unable to be ascertained from the data held by the Year 2000 Unit.

4.2.17 **Audit also identified that a risk assessment of the critical business processes and systems had not been undertaken to identify those which represent the greatest risk to the State as a whole.**

Cost of public sector Year 2000 projects

4.2.18 Table 4.2A details the expenditure incurred by government departments and agencies in addressing the Year 2000 issue, based on information reported to the Year 2000 Unit, and the total remaining expenditure required to be incurred, as estimated by public sector agencies.

TABLE 4.2A
VICTORIAN PUBLIC SECTOR, YEAR 2000 COSTS, AS AT 12 APRIL 1999
($million)

Funding source	*Actual expenditure (a)*	*Funds yet to be expended*	*Total estimated cost*
1997-98 Budget *(b)*	106	nil	106
1998-99 Budget	122	189	311
1999-2000 Budget	2	107	109
Total	**230**	**296**	**526**

(a) Does not include the costs associated with Year 2000 Unit itself, and other costs associated with managing the issue, such as those incurred by the Department of State Development and the Victorian WorkCover Authority on their Year 2000 private sector awareness campaign. In addition "actual expenditure" shown in the table includes the amount spend as advised by public sector agencies and would not include amounts committed etc.

(b) Includes amounts spent to 30 June 1998.

4.2.19 It is important to recognise that the above table does not include the costs associated with the Year 2000 Unit itself, and other costs associated with managing the issue, such as those incurred by the Department of State Development and the Victorian WorkCover Authority on their Year 2000 private sector awareness campaign.

4.2.20 Total cost to the State of the Year 2000 project as set out in the table amounting to some $526 million, includes an amount of $179 million for upgrading information technology systems that had been previously included in expenditure plans for future years that will now be brought forward and expended in the current financial year.

4.2.21 **The table highlights that $296 million, or 56 per cent of the estimated total cost of Year 2000 activities, was yet to be expended as at April 1999 and, accordingly this amount will need to be expended in an 11 week period to 30 June 1999 in order to achieve the Government's target date of 30 June 1999 for Year 2000 readiness.**

The Year 2000 Risk Management Unit

4.2.22 The Year 2000 Risk Management Unit (the Year 2000 Unit) was established by the Government in July 1998 within the Department of Treasury and Finance to monitor the State's preparedness for the Year 2000 issue across all public sector agencies.

4.2.23 Many of the Year 2000 Unit's functions were previously performed by the Department of State Development, in particular the responsibility for ensuring that the Government's response to the Year 2000 date change was co-ordinated and coherent. The Unit's key responsibilities include the:

- monthly collection of Year 2000 status information from all agencies and business functions, on a portfolio basis; and
- monthly compilation of this information for summary presentation to government Ministers.

4.2.24 Based on information provided by public sector agencies, the Reports prepared by the Year 2000 Unit range from high level reports to the Premier and the Minister for Finance, which provide summary details of the average Year 2000 preparedness across an entire ministerial portfolio and on an agency group basis, through to more detailed agency level reports which provide the status of systems and/or processes for use at an agency, agency group or portfolio level.

4.2.25 Each public sector agency has appointed a Year 2000 co-ordinator who is responsible for co-ordinating activities associated with the Year 2000 issue. Co-ordinators are also responsible for the completion of the monthly questionnaires for the Year 2000 Unit which detail the completed tasks within the 6 identified phases for achieving Year 2000 readiness, and the agency's assessment of the percentage of work completed for each phase.

All organisations which rely on information technology systems and equipment with electronic chips which have date functionality, have to confront the Year 2000 issue.

Centrally calculated data on Year 2000 activities

4.2.26 The Year 2000 Unit assesses the information provided by agencies using a pre-determined weighting system for each task to calculate the percentage of work completed for each phase. The percentage of work completed for each phase is then averaged at an agency and portfolio level.

4.2.27 However, the Year 2000 Unit does not reconcile or investigate differences in the "percentage complete" it assigns to each phase to that estimated by the responsible agency. The Unit advised audit that it had previously investigated variances as part of the early training phase of the introduction of the reporting regime. **Audit identified significant differences in the percentage completion assumed by the Year 2000 Unit and that estimated by the responsible agencies, which required investigation to ensure that the information reported on the State's Year 2000 readiness is the most reliable and accurate.**

Lack of Statewide risk assessment of critical business processes and systems

4.2.28 The Year 2000 Unit reporting regime uses a colour coding system to represent an agency's or portfolio's overall status in terms of the average percentage of Year 2000 work complete. The colours used and their meaning, as determined by the Year 2000 Unit, are as follows:

Red	***Program currently behind schedule - ensure project plan in place.*** Indicates that the project is currently more than 20 per cent behind schedule.
Yellow	**Program currently behind schedule - review project plan.** Indicates that the project is less than 20 per cent behind schedule. Due to the nature of Year 2000 project management, according to the Year 2000 Unit this may be acceptable, but nevertheless should be assessed in order to ensure Year 2000 readiness.
Green	**Program currently on or ahead of schedule.** Indicates that the program to achieve Year 2000 readiness is on target, or completed.
White	**Program not yet due to commence.**

4.2.29 The Premier and the Minister for Finance oversee the preparedness of the State for the Year 2000 issue by reviewing high level summary reports produced by the Year 2000 Unit on each ministerial portfolio. The summary information presented to the Premier and the Minister for Finance by the Unit does not detail individual critical business processes and/or systems, rather comprises a single colour coded assessment of average progress achieved on a whole-of-portfolio and agency group basis for each phase of implementation and on an overall basis. In addition, each agency group has been assigned an "import rating" in the summary reports representing a risk rating set at an agency group basis. Further comment on the agency risk rating process is included later in this Report.

4.2.30 **Audit identified that the Year 2000 Unit reporting regime does not include a risk assessment of the critical business processes and/or systems to identify those which represent the greatest risk to the State as a whole.** Such an assessment could be based on the potential impacts on community health and safety, business continuity, security and the economy on the State as a whole, as opposed to the current assessment which is agency-based.

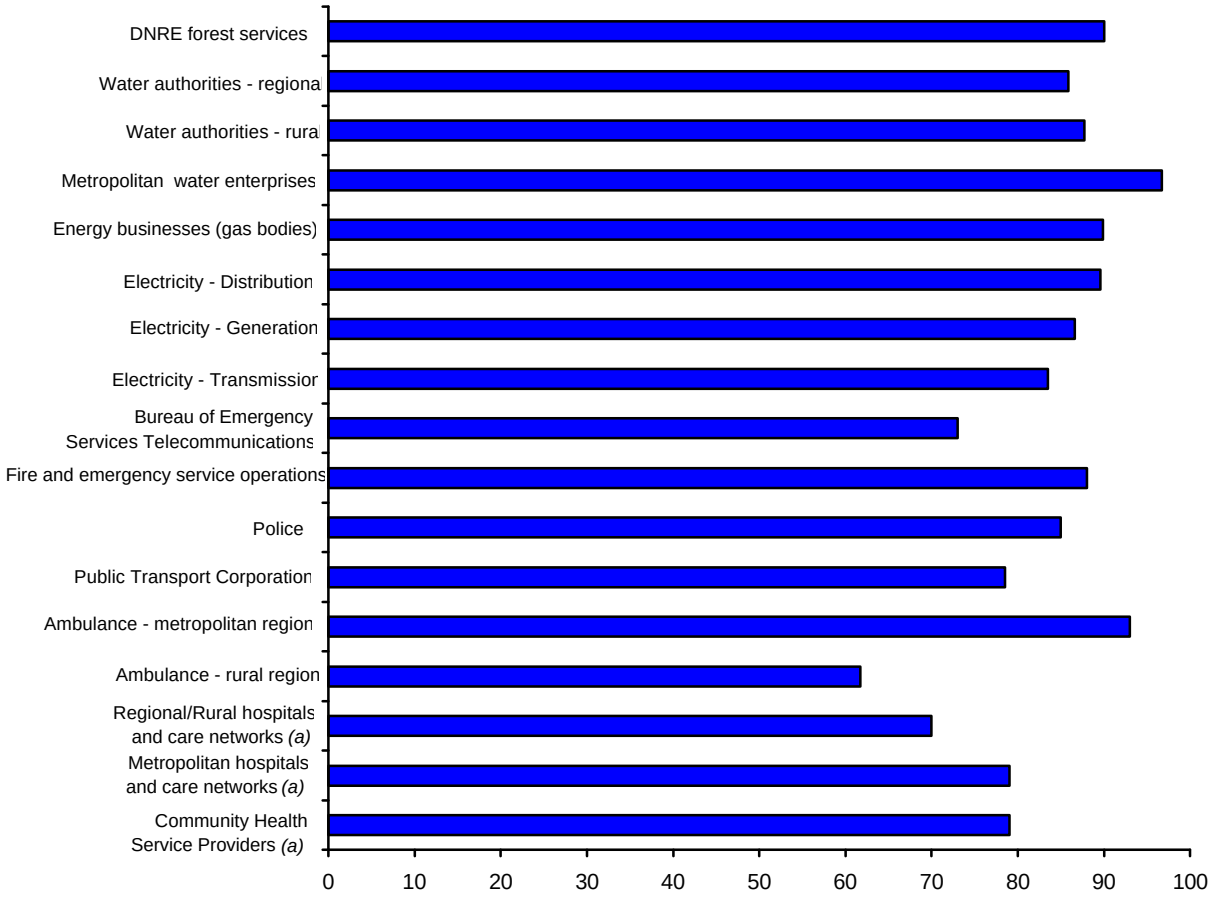
4.2.31 **The absence of reporting to the Premier and the Minister for Finance on the Year 2000 readiness of the most critical business processes and systems, that is, those which pose the greatest risks on a whole-of-government basis, together with the absence of an exception reporting regime, means that the Premier and the Minister for Finance may not be in an optimal position to become aware of situations where the overall progress for the most critical business processes and systems is behind best practice and to ensure that issues are resolved in a timely fashion.**

Overall Year 2000 readiness of the State

4.2.32 The reports prepared by the Year 2000 Unit based on its analysis of survey data provided by public sector agencies and its definition of what constitutes Year 2000 readiness indicate that, as at 12 April 1999, public sector agencies were 92 per cent complete in achieving Year 2000 Readiness by 30 June 1999, excluding preparation of contingency plans. The Unit also reported that contingency plans had been completed for around 72 per cent of the identified critical systems and/or processes as at 12 April 1999.

4.2.33 Chart 4.2B outlines the Year 2000 readiness of several agencies that are responsible for providing essential public services in Victoria, as assessed by the Unit, not including contingency planning and sign-off, as at 12 April 1999.

CHART 4.2B
YEAR 2000 UNIT ASSESSMENT OF READINESS OF SELECTED AGENCIES AS AT 12 APRIL 1999, NOT INCLUDING CONTINGENCY PLANNING AND FINAL SIGN-OFF
(per cent complete)



(a) Represents the mean level of completeness across the group of agencies in the sector.

4.2.34 **The chart indicates, based on the data held by the Year 2000 Unit, that selected essential services agencies are considered to be on schedule to achieve Year 2000 compliance as planned. However, the chart also shows that there are several agencies that are not as progressed as others, such as metropolitan and rural hospitals, rural ambulance service, public transport corporation and Bureau of Emergency Services Telecommunications, and require a greater effort to achieve Year 2000 compliance by 30 June 1999.**

Year 2000 project phases

4.2.35 The Year 2000 Unit monitors the progress of public sector agencies in achieving Year 2000 readiness during the following 6 phases.

Phase 1: Management Commitment - which covers how the management of each organisation:

- raises awareness of the Year 2000 issue;
- assigns responsibilities;
- identifies relevant stakeholders;
- supports budget approval requirements; and
- undertakes regular reporting and review of the progress of Year 2000 project(s) to ensure that milestones are being achieved.

Phase 2: Inventory, Risk Assessment and Impact Analysis - which covers:

- gathering of internal information;
- certification from external service providers;
- conduct of an inventory of all systems and/or processes;
- identification of business-critical processes and/or systems;
- performance of Year 2000 compliance assessment of each critical system; and
- determination of the impact on the critical business functions resulting from a failure in the business systems and/or processes.

Phase 3: Strategic Planning and Resource Allocation - which covers:

- evaluating and choosing options, such as repair, retire or replace;
- the preparation of a detailed project plan;
- the drafting of testing strategies; and
- enlisting resources and solution providers.

Phase 4: Remedial Activity and Compliance Testing - which covers:

- development of a detailed remediation project plan;
- business and technical staff being secured;
- systems and data test plans being prepared;
- test platforms being in place;
- integration testing with external parties; and
- full testing on all systems with test results being logged and clearly documented.

Phase 5: Contingency Planning - which covers:

- development of a clearly defined strategy which will ensure business continuity during the transition of the key Year 2000 dates;
- establishment of business resumption teams;
- development and testing of contingency and transition plans including a plan for non-supply from external service providers;

- assignment of responsibility for the implementation of the contingency plan and dealing with operational issues;
- identification of stakeholders involved in the testing process;
- establishment of change management control procedures on all hardware and software upgrades and additions; and
- development of a post-Year 2000 verification strategy;

Phase 6: Certification and Ministerial Sign-off - which represents the final sign-off of the process and requires:

- the business manager and project manager to sign-off the status of the project; and
- the internal auditor to sign-off that the process has been adhered to.

Inventory, risk assessment and impact analysis phase

4.2.36 This phase of the project, *inter alia*, requires the identification and assessment of critical business systems and/or processes. The Year 2000 Unit has defined critical business systems and/or processes as those that are essential for the mission statement, goals and objectives of the organisation to be achieved. More particularly, this includes all business systems and/or processes that are essential for the continuity of service delivery for those services that are normally delivered by the portfolio agency completing a questionnaire.

4.2.37 Following the completion of the initial inventory, agencies were then required to complete a risk assessment and impact analysis including a Year 2000 compliance assessment of critical business systems and/or processes. Each business system and/or process was required to be assessed against the following risk areas:

- community safety;
- financial risk;
- political impact;
- budget resources;
- legal, law and order; and
- urgency to the community.

The Year 2000 issue may impact on all organisations including those providing emergency services.

4.2.38 Based on data received by the Year 2000 Unit, all public sector agencies have completed an inventory of business-critical systems and/or processes which has resulted in the identification of 26 560 business systems and/or processes as being critical to the delivery of services, representing a significant decease over the previous month. **However, as at 12 April 1999, around 1 770 or 7 per cent of the systems and/or processes that were identified in the inventory as critical, had not been assessed for Year 2000 compliance and for the possible impact of the failure of those systems on service delivery.**

Strategic planning and resource allocation phase

4.2.39 The risk assessments performed in the previous stage of the project allow an informed decision to be made as to the appropriate remedial action to be undertaken and the resources required for planning purposes. Table 4.2C outlines the status of preparation of remediation action plans and the determination of resource requirements for the realisation by agencies of those plans, based on data held by the Year 2000 Unit.

TABLE 4.2C
STATUS OF ACTION PLANS AND SPECIFICATION OF RESOURCE REQUIREMENTS
AS AT 12 APRIL 1999

Status	*Number of critical systems and/or processes*	*Per cent*
Complete	18 135	68
Incomplete *(a)*	4 258	16
Unable to ascertain	4 167	16
Total critical systems/processes	**26 560**	**100**

(a) Includes those systems and/or processes which had not completed the previous phase.

4.2.40 **Table 4.2C shows that remediation action plans had not been prepared for at least 4 250 critical systems and/or processes, which represent 16 per cent of the total critical systems and/or processes as at 12 April 1999. In addition, the status of remediation action plans for a further 4 160 critical systems and/or processes was unable to be ascertained from data held by the Year 2000 Unit.**

4.2.41 **As a matter of priority, the status of the 4 160 critical systems and/or processes which cannot be ascertained from Year 2000 Unit data should be followed-up to ensure that appropriate action takes place to establish their status and that they achieve Year 2000 compliance by the Government's deadline.**

Remedial activity and compliance testing phase

4.2.42 Industry experience and research suggests that the resources used in remedial activity, testing and implementation comprises a major proportion of the total level of effort required in a Year 2000 project. According to IBM, major information technology consultants agree that Year 2000 testing will take 40 to 60 per cent of the total Year 2000 transition effort. IBM has subsequently encouraged its customers to sharpen their focus on Year 2000 testing and to accelerate their plans.

4.2.43 Table 4.2D provides a summary of the status of remedial and compliance testing activities by public sector agencies, based on data held by the Year 2000 Unit.

TABLE 4.2D
REMEDIAL AND COMPLIANCE TESTING ACTIVITY, AS AT 12 APRIL 1999

Status	*Number of critical systems and/or processes*	*Per cent*
Complete	9 577	36
Incomplete *(a)*	10 628	40
Unable to ascertain	6 355	24
Total critical systems/processes	**26 560**	**100**

(a) Includes those systems and/or processes which had not completed the previous phases.

4.2.44 **Table 4.2D shows that remedial and compliance testing activities have not been completed for at least 10 620 critical systems and/or processes, which represents around 40 per cent of the total critical systems and/or processes as at 12 April 1999. In addition, the status of remedial and compliance testing activities for a further 6 350 critical systems and/or processes was unable to be ascertained from data held by the Unit.**

4.2.45 **As a matter of urgency, agencies should complete the remediation of all critical business processes/systems. In addition, the status of the 6 355 critical systems and/or processes which cannot be ascertained form Year 2000 Unit data should be followed-up to ensure that appropriate action takes place to establish their status and achieve Year 2000 compliance by the Government's deadline.**

4.2.46 Historically, information system projects are not always delivered on time and within budget and, given the extent of effort required in remediating systems for the Year 2000 issue and the volume of work still to be completed, the target implementation date of 30 June 1999 may represent a formidable target for some agencies. In addition, if agency Year 2000 plans have not made adequate provision for slippages, this could also put more pressure on the target date of 30 June 1999.

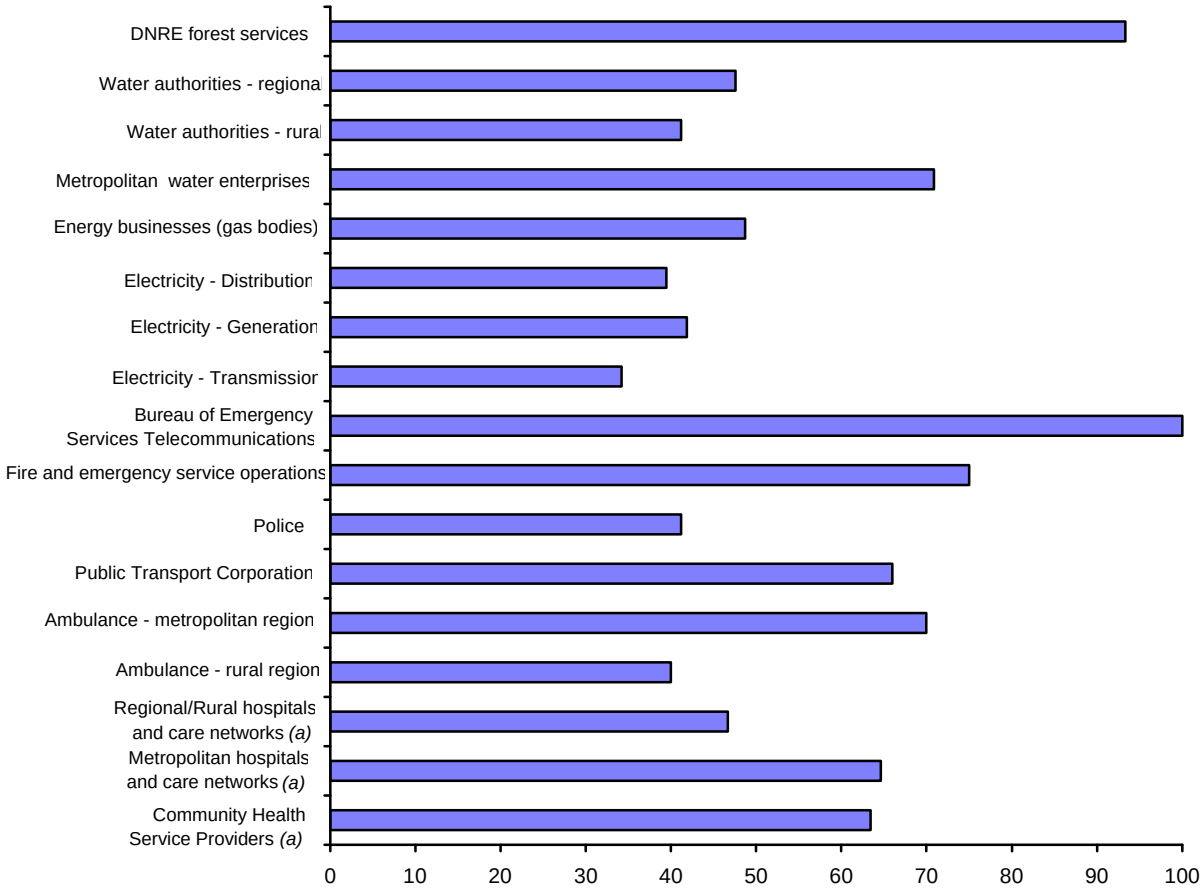
4.2.47 **In light of the extent of work yet to be preformed, and the fast approaching deadline of 30 June 1999, there is a need for agencies to re-assess the criticality of all identified business processes and supporting systems and to prioritise outstanding tasks to be performed.**

Contingency planning phase

4.2.48 Contingency planning is concerned with ensuring critical business functions can continue after an unexpected event, albeit in a downgraded mode. In this context, it is important for any agencies to develop contingency plans to mitigate the impact of all possible adverse events, including those which may arise as a consequence of the Year 2000 issue, in order to ensure the ongoing provision of essential services to customers without major disruption.

4.2.49 The reports prepared by the Year 2000 Unit indicate that, as at 12 April 1999, contingency planning in respect of the Victorian public sector was around 72 per cent complete. Chart 4.2E outlines the status of the development of contingency plans by agencies providing essential public services as at 12 April 1999, based on data held by the Year 2000 Unit.

CHART 4.2E
STATUS OF CONTINGENCY PLANNING BY SELECTED AGENCIES THAT PROVIDE ESSENTIAL PUBLIC SERVICES, AS AT 12 APRIL 1999
(per cent complete)



(a) Represents the mean level of completeness across the group of agencies in the sector.

4.2.50 Table 4.2F further provides an overall summary of the status of the preparation of contingency plans by public sector agencies.

TABLE 4.2F
STATUS OF CONTINGENCY PLAN PREPARATION BY ALL PUBLIC SECTOR AGENCIES, AS AT 12 APRIL 1999

Status	*Number of critical systems and/or processes*	*Per cent*
Complete	7 814	29
Incomplete	7 098	27
Unable to ascertain	11 648	44
Total critical systems/processes	**26 560**	**100**

4.2.51 **Table 4.2F shows that contingency plans have not been completed for at least 7 090 critical systems and/or processes, which represents around 27 per cent of total critical systems and/or processes as at 12 April 1999. In addition, the status of contingency plans for a further 11 640 critical systems and/or processes was unable to be ascertained from data held by the Year 2000 Unit. On the basis of this analysis, the majority of the total effort required is still pending.**

4.2.52 While all agencies have various forms of recovery plans and back-up systems in place, these measures alone will be insufficient in the event that systems fail as a result of the Year 2000 issue. **Accordingly, as a matter of urgency, agencies should identify options and develop actions for the timely preparation of contingency plans for all critical business processes and systems.**

4.2.53 **In light of the extent of work yet to be preformed, and the fast approaching deadline of 30 June 1999, there is a need for agencies to re-assess the criticality of all identified business processes and supporting systems and to prioritise outstanding tasks to be performed. In particular, the issue of testing contingency plans needs to be given special consideration.**

❒ ***RESPONSE*** *provided by Deputy Secretary, Department of Treasury and Finance*

The Victory 2000+ Audit Process developed by the Victorian Government is achieving the desired result. The last Public Disclosure Statement identified that the Victorian Public Sector was 92 per cent Y2K ready based on average progress through total activity to achieve readiness and 72 per cent through the contingency planning process, with the expectation that the next report will show a further improvement in these figures.

Clearly, the Victory 2000+ Audit Process has brought a high level of discipline to the Victorian Government's management of the exposure.

To this end, the Victory 2000+ Audit Process already contains an in-built weighting on the criticality of the individual BCS in providing services to community and business post 31 December 1999. This weighting is included in the report provided to both the Premier and the Minister, in addition to an exception report, which is part of the Cabinet submission that accompanies the report.

The imposition of a 30 June 1999 deadline on all Y2K readiness projects has highlighted those agencies unable to meet the Government's directive. Agencies currently indicating an inability to meet the deadline are prioritised based on the importance rating. Additional focus is then placed on these agencies and assistance provided where required.

The Y2K issue is a major priority of the Victorian Government and, as illustrated in both the reports to Cabinet and the Public Disclosure Statement, the Government is doing everything possible to minimise the potential problems that may occur come the new millennium.