VICTORIA

Auditor General
Victoria

# REPORT ON PUBLIC SECTOR AGENCIES

# Results of special reviews and other studies

# August 2004

# AUDITOR GENERAL
# VICTORIA

The Hon. Monica Gould MP
President
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I am pleased to forward this report to you for presentation to each House of Parliament, pursuant to section 16 of the *Audit Act 1994.*

Given the significance of the issues covered by the special reviews included in the report, pursuant to section 16AB of the *Audit Act 1994* I wish to transmit the report to parliament at the earliest possible opportunity (while parliament is in recess) to ensure that members are informed on these issues on a timely basis.

A full copy of the report will be made available on our internet website <www.audit.vic.gov.au> as required by section 16AB(4)(c) of the *Audit Act 1994.*

Yours faithfully

JW CAMERON
*Auditor-General*
17 August 2004

# Contents

# Foreword

This report contains the results of recently completed special reviews and other studies.

The first part reports on the results of 2 special reviews. The first examines the operation of water trading in Victoria. The second assessed the management of purchasing and accounts payable activity across the public sector. In both cases, the report identifies a need for improvement in the areas examined, including a need for structural and administrative reform in the case of water trading. Recommendations are provided to strengthen agency practices and governance arrangements.

The second part of the report presents the results of a performance audit examining the development of policy advice by government departments, and the results of a study of the progress made by the Environment Protection Authority to address the significant matters raised in our June 2002 performance audit report entitled *Managing Victoria's air quality*.

In the case of policy advice, the report identifies various opportunities for departments to improve the planning and management of policy development, and to better inform ministers about the risks associated with recommended policy positions. In the case of air quality management, the report recognises the positive action taken to address certain of our previous concerns, but identifies a continuing need for action in a number of important areas, including the evaluation of major improvement initiatives to assess their effectiveness.

Finally, the report explains the reasons for the deferral of a planned performance audit of the management of community correction orders administered by the Department of Justice.

JW CAMERON
*Auditor-General*

17 August 2004

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# 1. Executive summary

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# 1.1    Introduction

This report is organised into 2 parts, following this executive summary:

- Part 2 – presents the results of 2 special reviews
- Part 3 – outlines the results of a performance audit, the status of matters raised in a previous performance audit report, and an interim report on the deferral to a future date of a performance audit that was previously proposed for 2003-04.

The major conclusions and recommendations from these special reviews and other studies are presented below.

# 1.2    Special reviews

## 1.2.1  Water trading in Victoria

Water rights and water trading are major issues for rural communities and for the agricultural sector. Water trading is a relatively new and complex activity and occurs in only a few places in the world. The Department of Sustainability and Environment (DSE) and Victoria's 5 rural water authorities have made significant progress in recent years in promoting water trading, and in ensuring the efficiency and integrity of the water market.

This is a commodity market in which increasingly large amounts of resource are being traded for increasingly large amounts of money. The risks are already significant, and increasing.

Our audit found that the industry-wide governance arrangements were not adequate. There needs to be greater segregation of the functions of processing and recording of water trades, recording of water rights and licences, environmental regulation and water supply. The various entitlement registers maintained by the authorities need to be rationalised, as do their various internal registers. Water trading procedures and documentation need to be standardised across the industry. The market and the public need much better information about water entitlements and about all aspects of water trading.

Our audit examined the water trading activities of Goulburn-Murray Water (G-MW), Victoria's largest rural water authority. While acknowledging recent efforts by G-MW to strengthen oversight of its Watermove water trading exchange, oversight remains inadequate. With respect to water trading:

- not enough information is reported to G-MW's board
- business planning needs further development, as does performance and risk management

- a number of the internal controls required to ensure compliance with laws and regulations, risk (including fraud) management, adherence to procedures, and accurate and up-to-date record-keeping either do not exist, or are not adequate
- the coverage and frequency of internal audits of water trading, the market information available to licence and water rights holders and the information provided to the broader community on water trading, are not adequate.

Following the completion of a wide-ranging review of the water industry, including water trading, the government recently released an action plan setting out various strategies, initiatives and future directions for the industry. The results and recommendations of this audit, which are broadly consistent with the thrust of the action plan, should be considered by the government in the finalisation of its industry reforms and implementation strategies.

## Recommendations

**Several recommendations were made focusing on the need for government and water authorities to strengthen the current arrangements for water trading, including the need to:**

- **restructure current agency responsibilities for recording water trades, the registration of licences and water rights, the supply of water, and some aspects of the environmental regulation of water trades**
- **record all information required to approve water trades either in a single statewide register or individual registers maintained by water authorities**
- **hold discussions with other relevant Australian jurisdictions on the possible establishment of single entitlement register (or electronic linking of state registers) for water traded in the Murray-Darling Basin**
- **improve public access to records of water rights and licences**
- **improve the extent and quality of information that is publicly available about water trading**
- **strengthen G-MW's oversight and control of water trading operations**
- **improve the current audit arrangements over water trading activity.**

## 1.2.2 Management of procurement and accounts payable

The purchase of, and payment for, goods and services are core activities of all public sector agencies. They are also major points of contact between government and business, with very significant financial implications for both.

We assessed how well selected agencies managed their procurement and accounts payable activities, including their compliance with established administrative and legislative requirements. We also examined the role the Victorian Government Purchasing Board (VGPB) played in establishing public sector procurement policies and requirements, and oversighting public sector procurement more generally.

While we identified a number of improvement opportunities, we concluded that the management of procurement and accounts payable activities was adequate, with the agencies subject to review generally having:

- adequate controls (manual and automated) over these activities
- complied with legislative requirements.

A strength noted in the current procurement environment is the requirements of the VGPB. The audit found these requirements to be highly effective. Consideration should, however, be given to broadening the range of agencies subject to them.

Agencies indicated that the requirements for the public disclosure of contracts over $100 000 are somewhat unclear, in particular in relation to contracts entered into under legislation other than the *Financial Management Act 1994*. This uncertainty detracts from the otherwise clear guidance and compliance in relation to the public disclosure of major contracts.

In relation to the payment of accounts, many instances were identified where agencies did not complete purchase orders prior to the acquisitions of goods. The approval of orders after the acquisitions increased the risk associated with the management of commitments.

Agencies met supplier terms in the majority of cases, however, the level of non-compliance with terms was still significant. In addition, in an environment where electronic funds transfer is an efficient and effective payment method, it was disappointing that 40 per cent of payments were still being made by cheque. The use of mail to inform suppliers that payment had been made, in 90 per cent of cases, adds unnecessary cost for paying accounts. Agencies need to investigate whether this can be achieved electronically.

### ᴐ Recommendations

**Several recommendations were made focusing on the need to strengthen and broaden current public sector agency purchasing requirements and controls, including to:**

- **require all agencies subject to the *Financial Management Act 1994* to comply with VGPB policies and practices**
- **clarify the current public disclosure requirements for major contracts**
- **require agencies to periodically provide assurances to the VGPB regarding their compliance with government policies for public disclosure of major contracts**
- **establish arrangements to enable the VGPB to undertake audits or collect information from agencies subject to its requirements, to support independent review and validation of annual supply reports provided by agencies to the VGPB**
- **ensure that agencies establish appropriate expenditure delegations, which are complemented with systemic controls that ensure compliance with expenditure limits**
- **avoid duplicate payments to suppliers, through staff training and strengthened payment review procedures**
- **regularly review staff access, and levels of access, to accounts payable systems.**

**Recommendations were also made to improve the efficiency of public sector purchasing, through greater use of cross-government purchasing agreements; improved procedures to ensure that supplier payment terms are met; greater use of electronic purchasing and payment processes; and the development of appropriate performance management regimes.**

## 1.3    Performance audits

### 1.3.1 Development of policy advice

The provision of robust advice to government for informed decision-making on public policy issues is one of the most important responsibilities of the public sector. The primary sources of advice and supporting policy development in Victoria are government departments.

We examined whether selected departments developed well-researched, comprehensive policy advice briefs for government. This did not cover an assessment of the government decision-making process, the merits of policy advice or the implementation of this advice.

All 8 policy development projects we examined adopted sound processes to define the issues under consideration, and the scope and objectives of the policy advice, as well as systematically reviewed evidence gathered and available options.

Consultation during policy development was variable. Staff on the projects examined were generally skilled and experienced at liaising with government and other internal stakeholders. However, processes for engaging with external stakeholders need to be made more systematic and rigorous. All projects were committed to stakeholder consultation, but some would have benefited from better front-end planning to ensure that relevant stakeholders were systematically identified, and appropriate ways of consulting were identified.

The need for improved planning for consultation linked to a related need to apply disciplined project management methodologies. This includes better planning for project risk management, budget management and provision for project evaluation.

While all projects examined considered the risks associated with options and recommendations when advice was being developed, not all made explicit statements of risk when the minister was briefed. In some cases, risks were identified but not mitigation strategies. Failure to provide clear statements of any risks associated with recommendations can mean that either the minister is not informed, or that the departmental team makes only risk-averse recommendations.

The 3 departments examined were conscious of the need to develop and maintain the core capabilities of policy advice and recognised these responsibilities in their departmental planning. All were facing challenges of developing and maintaining staff skills in this area. It takes time and experience to build policy skills, and departments were addressing these needs in their work force and staff development planning.

## ✵ Recommendations

**The recommendations focused on the need for departments to:**
- **implement formal planning for stakeholder involvement in policy development**
- **prepare project plans (including budgets, key milestones and evaluation plans) appropriate to the size and complexity of policy development projects, and report progress against them**
- **ensure that policy advice to ministers appropriately incorporates the risks associated with recommended options, and the recommended mitigation strategies.**

## 1.3.2 Progress by the Environment Protection Authority in addressing the recommendations of our performance audit report, *Managing Victoria's air quality*

Our June 2002 performance audit *Managing Victoria's air quality* assessed how well the Environment Protection Authority (EPA) protected Victoria's air quality.

We concluded, in that report, that ambient (outdoor) air quality had improved significantly in the preceding 30 years and that Melbourne's air quality compared favourably with air quality in other Australian and overseas cities. Despite this, there were still 300 to 400 deaths and about 1 000 hospital admissions each year related to Melbourne's air quality.

The 2002 audit found that the EPA had controlled emissions from major industry and was also in the process of controlling pollution from motor vehicles, small-to-medium enterprises and diffuse sources such as wood heaters. Scope for improvement was also found in a number of the EPA's internal corporate governance practices.

Broadly, we recommended that the EPA:
- improve the information basis of its planning and resourcing practices and decisions
- develop an equipment acquisition and replacement strategy and improve data collection practices
- maximise the benefits of its air quality management activities, by formalising working arrangements with other agencies, completing its marketing strategy, evaluating the effectiveness of its activities and reporting adequate air quality information.

Our recent follow-up audit concluded that the EPA had implemented some of the recommendations in our 2002 report. However, there had been little or no progress in a number of areas, including:

- establishing formal arrangements with key agencies in areas of mutual responsibility
- developing a marketing strategy
- evaluating the effectiveness of each of the major activities it undertakes to improve air quality
- monitoring and reporting internally on progress made in implementing the State environment protection policy (Air Quality Management) attainment program.

### Recommendations

**Several recommendations emphasised the continued need for the EPA to improve its practices in the outstanding areas.**

## 1.3.3 Managing offenders on community corrections orders - interim report

At any one time, around 8 000 offenders are supervised by corrections officers of the Department of Justice while undertaking community work and attending educational or treatment programs.

The department is presently undertaking a redevelopment of correctional services. Strengthening the management and rehabilitation of offenders who serve their sentences in the community is a key aspect of this reform program.

While the department has made significant progress in the redevelopment of community corrections, key initiatives which will affect the way offenders are managed have not yet been completed.

Our 2003-04 annual plan proposed an audit to assess the efficiency and effectiveness of the department's management of community correction orders. In the current circumstances, it was considered prudent to defer completion of this performance audit to allow time for the department's reform program to be fully implemented.

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# 2. Special reviews

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## 2.1    Water trading in Victoria

### 2.1.1 Audit conclusion

Water rights and water trading are major issues for rural communities and for the agricultural sector. Water trading is a relatively new and complex activity and occurs in only a few places in the world. The Department of Sustainability and Environment (DSE) and Victoria's 5 rural water authorities have made significant progress in recent years in promoting water trading, and in ensuring the efficiency and integrity of the water market.

This is a commodity market in which increasingly large amounts of resource are being traded for increasingly large amounts of money. The risks are already significant, and increasing.

Our audit found that the industry-wide governance arrangements were not adequate. There needs to be greater segregation of the functions of processing and recording of water trades, recording of water rights and licences, environmental regulation and water supply. The various entitlement registers maintained by the authorities need to be rationalised, as do their various internal registers. Water trading procedures and documentation need to be standardised across the industry. The market and the public need much better information about water entitlements and about all aspects of water trading.

Our audit examined the water trading activities of Goulburn-Murray Water (G-MW), Victoria's largest rural water authority. While acknowledging recent efforts by G-MW to strengthen oversight of its Watermove water trading exchange, oversight remains inadequate. With respect to water trading, not enough information is reported to G-MW's board. Business planning needs further development, as does performance and risk management. A number of the internal controls required to ensure compliance with laws and regulations, risk (including fraud) management, adherence to procedures, and accurate and up-to-date record-keeping either do not exist, or are not adequate. The coverage and frequency of internal audits of water trading, the market information available to licence and water rights holders and the information provided to the broader community on water trading, are not adequate.

Following the completion of a wide-ranging review of the water industry, including water trading, the government recently released an action plan setting out various strategies, initiatives and future directions for the industry. We suggest that the results and recommendations of this audit, which are broadly consistent with the thrust of the action plan, be considered by the government in the finalisation of its industry reforms and implementation strategies.

## 2.1.2 Background

### What is water trading?

Over 4 800 gigalitres of water is used in Victoria each year. Each gigalitre contains 1 000 megalitres, with each megalitre roughly equal to the volume of water required to fill an Olympic size swimming pool. The vast majority (83 per cent) of this water is put towards rural use, with the balance used by urban communities, commerce and industry. Almost all rural water (93 per cent) is used to irrigate farms.

The Crown owns all water. The allocation of water resources in Victoria is governed by the *Water Act 1989.* The Act allows individuals and organisations to access the state's water resources, for a fee, if they hold a:

- renewable surface water licence (which allows the holder to divert water from a river or stream for up to 15 years)
- groundwater licence (which allows the holder to extract water from an aquifer for 15 years)
- water right (which allows the holder to access water in irrigation districts indefinitely).

The Act provides Victoria's 5 rural water authorities[1] with bulk water entitlements, so they can provide licence and entitlement holders with water.

Licences and water rights do not give holders an absolute right to a specified volume of water, but a right to access the specified amount of water annually if it is available. This is known as a water entitlement.

When the amount of water available in a district or from a river system is greater than the total water entitlement, licence and water right, holders can buy a percentage of this excess water (known as sales water) equal to the percentage of their entitlement to water in the district or system. Conversely, when the available water is less than the total water entitlement, licence and water right holders only receive a percentage of water equal to the percentage of their water entitlement in the district or system.

The total volume of water available for use by a holder of a water entitlement is known as their seasonal water allocation[2]. These allocations are initially set in July each year, then reviewed monthly. Figure 2.1A provides an example of how water allocated to entitlement holders is calculated.

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[1] The 5 rural water authorities are Goulburn-Murray Water, Sunraysia Rural Water Authority, First Mildura Irrigation Trust, Gippsland and Southern Rural Water Authority and Wimmera Mallee Water.

[2] The seasonal water allocation equals the water entitlement plus sales water (if there is excess water), or a quantity less than the water entitlement (if there is not enough water to meet all the entitlements).

**FIGURE 2.1A: CALCULATION OF WATER ALLOCATIONS FOR ENTITLEMENT HOLDERS (AN EXAMPLE)**

| Farmer A | Year 1 | Year 2 | Year 3 |
|---|---|---|---|
| Diversion licence | 100 ML | 100 ML | 50 ML (4) |
| Water right | 200 ML | 200 ML | 100 ML (4) |
| Total water entitlement | 300 ML | 300 ML | 150 ML |
| Sales water (1) | 100 ML | - (3) | - (3) |
| Water available to Farmer A (2) | 400 ML | 300 ML | 150 ML |

Assume that Farmer A has a 100 ML water licence and 200 ML water right.

1.  Additional water offered by authority to right holder for purchase.
2.  Water available to Farmer A can be used or sold.
3.  Due to climatic conditions, no sales water allocation provided in these years.
4.  Due to climatic conditions, Farmer A was only permitted to access half the entitlement.

Currently, the volume of water allocated through water rights and surface water licences amounts to approximately 2 000 and 500 gigalitres respectively, with the majority of the balance of available water sold to entitlement holders as sales water.

Licence and water right holders pay annual charges to one of the state's 5 rural water authorities. These charges must be paid whether or not they consume the water. They may also pay fixed charges for storage fees and access fees. For the water consumed they pay a variable usage fee.

Before 1989, each water right was tied to a specific parcel of land. The *Water Act 1989* changed this, by allowing water entitlements to be separated from land ownership. This enabled the creation of a market in water entitlements. Licences are the personal property of the licensees and tied to land by licence condition.

The Act allows for the trading of water entitlements either temporarily (usually for one year) or permanently. That means that holders can either:

*   use all or part of their seasonal water allocation
*   sell or transfer part or all of their water licence and water right permanently
*   sell or transfer part or all of their seasonal water allocation temporarily to another party.

Each year, about 25 gigalitres, or one per cent of the total water entitlements in Victoria are permanently traded and about 250 gigalitres (10 per cent) of the allocated volume is temporarily traded (sold, or transferred for no consideration). In the 2003-04 financial year, this trade consisted of about 450 permanent and 12 000 temporary trades. The total value of these trades is about $42.5 million a year.

Most trades are by holders of licences and water rights (mainly farmers using water to irrigate their farms). However, urban water authorities can (and do) trade parts of their bulk entitlements with other urban water authorities, and trade water with licence and water rights holders.

Water trading is very important for the economic growth of Victoria. It is widely recognised that it has led to:

- water moving from lower value use to higher value use (such as from grazing livestock to horticulture), adding about $100 million to the state's agricultural production each year
- development and employment opportunities
- less need for new dams and other public water storage infrastructure, by providing a ready and accessible supply of water to expand existing businesses and meet the needs of new users
- environmental benefits by moving water from degraded or environmentally sensitive areas to those more suited to irrigation.

The main risks with water trading are that trade may cause adverse environmental impacts or may adversely impact on other water users. In addition, if water trading is not adequately controlled, it can have adverse financial consequences on market participants, including water authorities.

## How water is traded

The first water trading under the *Water Act 1989* was by licence and water right holders, either dealing with each other directly or through a water broker. While a comprehensive set of rules and regulations were established to manage water trades, the trading processes used to match buyers and sellers were not transparent, and little information regarding the amount of water traded and the prices paid was publicly available.

There was widespread uncertainty and a lack of information about how the trading system operated and what trading meant for water entitlement holders. This made some entitlement holders less willing to trade.

In 1998, to address these problems and encourage water trading, G-MW established a public water exchange to trade water in the north of the state. G-MW is the state's largest rural water authority. The exchange - the Northern Victorian Water Exchange - aimed to have a transparent water trading process, and to provide information to the public about the volumes of water traded, and the prices paid. The exchange allowed temporary trading in:

- water rights and licences
- sales water

- bulk water entitlements
- "supply by" agreements (whereby authorities supply water for irrigation, commercial and recreational uses).

In August 2001, the Victorian Government (under its Waters for Growth Initiative) established a new statewide water exchange. This new exchange - Watermove - replaced the Northern Victorian Water Exchange. The Department of Sustainability and Environment (DSE) made G-MW responsible for managing Watermove, on behalf of the department and other rural water authorities.

As shown in Figure 2.1B, in 2003-04 approximately 25 per cent of all water trades in Victoria were recorded on Watermove. The remainder were private sales conducted directly by holders of licences and water rights, or through private brokers.

**FIGURE 2.1B: HOW ALLOCATED WATER IS TRADED (TEMPORARY TRADE)**
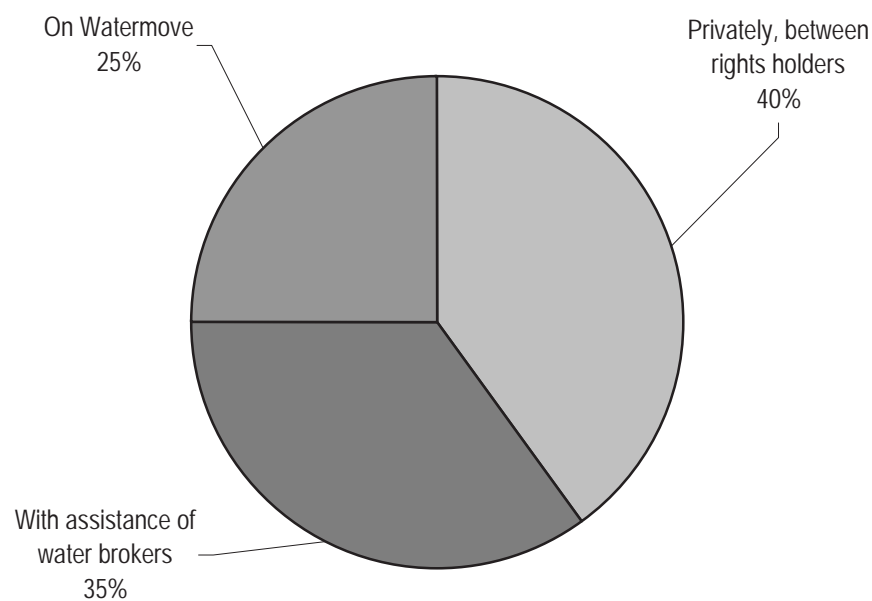


Under the current arrangements, water authorities are responsible for approving and recording all water trades within their areas of responsibility, whether transacted on Watermove or privately. Watermove effectively acts as a broker and, therefore, records only trades transacted through this exchange.

### Audit purpose and scope

In mid-2002, the former Minister for Conservation and Environment asked our Office to audit the state's water licence, entitlement and trading registers. DSE intended to have the 5 rural water authorities address any issues arising from the audit, and to then request us to provide annual written assurance about the state's water trading systems and procedures. DSE would then use this assurance to promote the reliability of the water trading systems and procedures, and build confidence in them.

In the context of the above request and the importance of water trading to the community and the state, we examined:

- the statewide governance framework, including the audit arrangements for water trading
- G-MW's systems and procedures used to record licences and water rights, seasonal water allocations, trades and the balance of water available for use
- compliance by G-MW with the *Water Act 1989*, state government agreements, ministerial directions, government policy and other requirements.

## 2.1.3  Is the water trading governance framework adequate?

"Governance" generally refers to the manner in which an organisation is managed, in order to achieve its strategic and operational objectives. It addresses:

- decision-making structures, processes and transparency
- internal controls established by management
- accountability for outcomes
- board oversight of senior management.

In assessing whether the governance framework for water trading was adequate, we examined if:

- water trading, recording of licences and water rights, environmental regulation and water supply functions were segregated
- timely and relevant information was reported to G-MW's board (as the governing body) and the public
- G-MW's systems, procedures and information for water trading were subject to an independent review
- the board and management of G-MW adequately oversaw water trading activities.

## Segregation of water trading, recording of licences and water rights, environmental regulation and water supply

Under the Council of Australian Governments Water Reform Framework, the state government agreed in 1994 to separate, as far as possible, the functions of water resource management, standard setting, regulatory enforcement and service provision. This was in line with widely accepted practice in other industries, to separate the incompatible roles of service provision and regulation.

The state government is responsible for policy, introducing legislation and regulations to prevent the state's water resources being overused, and for providing mechanisms for allocating water. In discharging these responsibilities, the government seeks to ensure the long-term sustainability of water resources, and ensure that water trading does not adversely affect other water users or the environment.

DSE, on behalf of the government, has overall responsibility for:
- developing policy
- sustainably managing the state's water resources
- setting environmental standards and rules
- monitoring the environmental impacts of water use and water trade
- establishing and maintaining mechanisms to enable water trades to be efficient and timely
- helping expand water trading, where it benefits the community.

Water authorities are responsible for:
- maintaining records of licences and water rights
- managing the water infrastructure (such as storage facilities, water channels and pipes)
- establishing seasonal water allocations, which supply water to licence and water rights holders
- administering water trading activities (approving, processing and recording trades)
- restricting water trades where there would be an adverse environmental impact on water resources or on the environment, resulting from the use or trade of water
- setting annual fees for licence and water rights holders (in consultation with water services committees, that are largely made up of entitlement holders.

In addition, G-MW is responsible for the matching of buyers and sellers in respect of Watermove trades.

The Environment Protection Authority (EPA) is responsible for environmental regulation in Victoria, including the regulation of traded water. However, in the context of water trading, it only:

- advises about environmental standards that deal with aspects of water trading
- oversees the management of environmental incidents involving irrigation water (such as chemical or toxic waste spills).

The state's 10 catchment management authorities are responsible for managing the state's water catchments, and for developing land and water management plans (in consultation with the EPA and other bodies such as the Murray Darling Basin Commission). These plans in effect set the environmental standards for water trading (such as restricting water trading in some irrigation zones for environmental reasons, setting water use limits, and setting standards for water discharged back into river systems following irrigation).

Under current arrangements:

- rural water authorities maintain records of licences and water rights, approve and record all water trades, regulate aspects of the trade and supply water
- organisations with resource management responsibilities (such as catchment management authorities and DSE) undertake aspects of environmental regulation
- no body independent of the water authorities monitors the compliance of water trading activities with environmental regulations.

Since 1 January 2004, the Essential Services Commission has regulated the water authorities' customer service and financial management. From 1 July 2005, the commission will set the prices charged by authorities for water right and licence fees and for water use.

At the time of our audit in July 2004, there were no proposals to take responsibility for the processing and recording of water trades, and the registration of licences and water rights, away from water authorities.

### *Conclusion*

We consider that the processing and recording of water trades, the registration of licences and water rights, environmental regulation and water supply are incompatible functions because:

- a potential conflict of interest exists for a water authority that both processes and records water trades and manages water supply: it may be reluctant to encourage and facilitate water trading because the trade of water outside its area could reduce its revenue

- a potential conflict of interest exists for water authorities that both process and record water trades, and monitor and ensure compliance with environmental and other regulations: if they wish to expand water trading, they may not adequately comply with regulations that might restrict trading.

We consider that these functions are not adequately segregated in the current governance framework.

Furthermore, where water trading is only a small part of a water authority's business, it is likely to receive less board oversight and management attention then it would in an organisation whose only business is the administration of water trading. This may restrict the development of water trading, and may contribute to the issues identified in our audit.

While acknowledging that segregation of these functions is likely to increase the cost of administering water trading, we believe the benefits of more clearly defined responsibilities and accountabilities, and the reduced potential for conflicts of interest arising, are likely to outweigh such costs.

We also accept that it is not practical to separate the approval of water trades and the processes to ensure that water trades do not have an adverse impact on the water environment, from water authorities. However, there is still a role for an independent regulator to ensure that water authority processes, designed to protect the environment from adverse effects resulting from the trade, are being complied with.

## Recommendation

1.  **That the government consider segregating (in separate organisations) the functions of processing and recording water trades, the registration of licences and water rights, the supply of water, and some aspects of environmental regulation of water trading.**

In considering this recommendation, revised arrangements could include:
- creating a new and separate agency, responsible for processing and recording all water trades
- using Land Victoria's considerable expertise in registering land titles to establish a similar system to register licences and water rights (such a system is being established in New South Wales and Queensland).
- a stronger role for the EPA and CMAs in setting environmental standards for water trading and for monitoring compliance with the standards.

### RESPONSE provided by Acting Chief Executive, G-MW

*Disagree. G-MW is concerned that full separation into separate organisations would be inefficient, significantly adding to processing complexity and reduce expediency. It is considered that the benefits will not out-weigh the costs of full segregation. G-MW believes that better segregation of duties within its organisation, supported by adequate auditing, could deliver similar outcomes to those sought by the recommendation. Please note:*

- *recording and approving of trades should and will be segregated from other functions in future*
- *registration of entitlements should and will be segregated from other functions in future*
- *regulation of water (we assume this is environmental regulation, as opposed to regulation of water down a river or channel system) is separate, in regard to water trading, with the approval of the site which will be irrigated following a water trade performed via Guidelines for Irrigation Development or similar guidelines, with referrals to all parties affected by the water trade, including Catchment Management Authorities, EPA, DSE and shires. Water is not transferred until these external parties are satisfied that the environmental impacts of the trade can be appropriately managed. This process will be further improved following White Paper reforms*
- *supply of water is presently segregated from the above functions.*
- *recommendation 15 appears to capture the essential improvement required here.*



*Hume spillway.*

## Timely and relevant reporting of water trading activity

In late 2003, G-MW prepared the first Watermove annual report. This report included information about:

- trade into and out of trading zones established by water authorities
- the weighted average trade price for permanent and temporary trades (by trading zone)
- the financial and operational performance of Watermove
- buy and sell offers received by Watermove
- performance indicators and targets
- an analysis of Watermove debtors.

G-MW's annual reports also include details of:

- permanent and temporary transfers of water rights and licences
- volume of water traded, the weighted average trade price and seasonal allocations per trading zone.

Other useful information on Watermove trading is publicly available from the Watermove website and G-MW's offices.

In respect of water trading activity more generally, various documents also provide additional information, including DSE's *Value of Water* publication, brochures issued by water authorities and information contained in their annual reports. However, there is no continuous (annual) public reporting of all water trading in Victoria.

In addition, access to records of water rights and licences (held by water authorities) is restricted, so this information is not freely available to the market.

Accountable and well-functioning markets need access to full information. This information would enable buyers, sellers and brokers to make informed trading decisions and the public to assess how well resource managers and regulators are meeting their responsibilities.

### *Conclusion*

We believe that all the information needed by water buyers, sellers and the public is not readily available to them at present. In addition to the topics listed above in the Watermove annual report, more comprehensive information is also needed for all water trading in Victoria about:

- potential surface and groundwater resources (based on storage capacity and analysed by catchment)
- water allocations approved under state agreements, such as the cap on water diversions from the Murray-Darling Basin's rivers
- bulk water entitlements established under the *Water Act 1989*

- water resources available at the reporting date (including surface water, groundwater, water in farm dams and recycled water)
- the allocation of water between urban use, rural use and the environment
- total water used and water allocations unused at year-end (by catchment)
- the volume and value of temporary and permanent water trades (by irrigation district)

While some of this information is available in the annual reports of water authorities, there is not a single document which provides statewide information.

It is important for records of water entitlements and licences to be public documents because there may be restrictions and caveats that are important to potential buyers. At present, buyers may not be fully informed about what they are buying.

## Recommendations

2.    **That records of water rights and licences be accessible to the public without restriction to help ensure an informed market.**

3.    **That DSE arrange for an annual report on water trading to be prepared:**
     - **with full information about water trades**
     - **covering all trades, not just trades transacted on Watermove**
     - **that is tabled in parliament.**

### RESPONSE provided by Acting Chief Executive, G-MW

*Qualified agreement to recommendation 2: Public access to records of water rights and licenses without restriction is a very broad recommendation. The authority is under pressure from customers who have complained from harassment from water brokers. These customers wish to have their privacy protected. Unlimited public access to all records without restriction could include access to use and water use licence details (including crop type etc.). These records could enable an external party to make estimates of the incomes of individual farmers, their overall financial position and their susceptibility to approaches to trade their water. Access to entitlements only may be satisfactory, once this is worked through with the privacy commissioner.*

*Recommendation 3 agreed.*

## Independent review of G-MW's systems, procedures and information for water trading

G-MW has an audit committee and internal auditors to periodically review its functions and activities. However, G-MW's water trading activities have only been audited twice by G-MW's internal auditors since trading began in 1990. The last audit was in January 2004.

G-MW engages a local accounting firm as Water Exchange Controller, to supervise water trades conducted via Watermove and confirm that the trading process is operating in accordance with G-MW's operating rules. Specifically, the controller confirms that:

- pool prices (the prices at which trades are transacted) are properly calculated
- the volumes offered for sale are actually available
- ballots (in the event that there are multiple bidders for the same water) are properly conducted, and that all traders have equal and fair access to the water
- offers listed in the exchange are genuine offers
- cancelled sale offers are withdrawn from the market.

Under the *Audit Act 1994*, the Victorian Auditor-General is responsible for providing independent assurance about information in financial statements of public sector agencies (through financial audits) and for assessing the management of agencies (through performance audits). Under the *Financial Management Act 1994*, agencies are required to provide information to the public about their financial and operating performance.

While rural water authorities are required by DSE to disclose certain water trading information in their annual reports, there is virtually no information about water trading in their financial statements as this activity does not generate significant revenues or expenses. Accordingly, little or no information about water trading is subject to annual independent audit review.

### *Conclusion*

The community expects that public sector agencies will responsibly manage community assets and their own operations. Water authority boards need to know that internal controls are working effectively and that their authority is complying with legislation and regulations. Water trading stakeholders (such as buyers and sellers, the agricultural industry, parliament and the public) need to know that DSE and the water authorities are managing water resources efficiently and effectively, with due regard for probity and fairness, and are complying with legislative and other requirements.

To satisfy these needs, stakeholders must be assured through:

- financial audits, that the information in financial reports can be relied on
- performance audits, that the performance of agencies is adequate.

G-MW's current internal auditing arrangements do not adequately meet the needs of its board, because the frequency and coverage of internal audits are inadequate. For example, the most recent audit in 2004 did not review Watermove IT controls or test whether the water entitlement register was adequately updated following water trades. However, this audit made a number of useful recommendations, which are currently being implemented by G-MW.

Little or no information on water trading is subject to external audit review. Accordingly, stakeholders do not obtain independent assurance over water trading activity.

## Recommendations

**4.    That each water authority's water trading activities be internally audited at least annually, and that audits cover all the major aspects, and risks, of water trading.**

**5.    That, in the event of an annual water trading report being produced, the report be made subject to audit by the Auditor-General.**

### RESPONSE provided by Acting Chief Executive, G-MW

*Agree in principle with the proposal for annual audits, but our preference is for a risk based approach to audit frequency, which may not necessarily be annually.*

*Recommendation 5 agreed.*

## G-MW management oversight of water trading activities

G-MW is responsible for managing water trading activities within its region, the north-east of the state, as well as all trading conducted on Watermove.

Recently, G-MW established a committee known as the Watermove Management Committee to oversee its water trading activities conducted on Watermove.

G-MW has prepared a 2003-04 business plan for Watermove, which included:

- objectives of water trading
- strategies proposed to achieve the objectives, with proposed outcomes and completion dates
- performance measures
- details of trading zones and products
- roles of the organisations involved in water trading.

The business plan only covered trading on Watermove.

G-MW indicated to us that its business planning for non-Watermove trades is included in its corporate plan. However, our review of the corporate plan disclosed little information on water trading.

The Watermove business plan identified proposed outcomes for each strategy, but did not indicate how G-MW proposed to achieve each outcome. Responsibilities for achieving outcomes were not assigned to specific personnel.

G-MW advised us of its intention to produce a 3-year strategic plan for Watermove, in addition to an annual business plan. Production of such a plan would bring a longer term perspective to its planning process. However, at the time of audit, the 3-year strategic plan had not been completed.

In addition, at the time of our audit, G-MW was developing a risk management strategy. It expected the strategy to cover water trading.

G-MW had a performance measurement process. Performance in 8 areas of Watermove's operations was measured using 14 performance measures, with targets set for each measure. However, all of the performance measures were not clearly linked to the objectives and strategies in the 2003-04 Watermove business plan. Also, G-MW had not yet measured its performance against the identified targets.

With the exception of performance measures relating to the processing of water trades, there were no other measures or targets for the administration of trading not conducted through Watermove.

G-MW had documented operating rules for water trading on Watermove, but not for trading that was not on Watermove.

While the G-MW board receives a monthly operations report that includes trade volumes and other business data, and receives the occasional board paper addressing water trading issues, we consider that there is further scope to improve the amount of information provided to it.

The revenue generated from trading is small compared with G-MW's total revenue, and the cost of administering trading is insignificant in relation to G-MW's total expenditure. This may explain why limited information about water trading is provided to the board.

### Conclusion

While acknowledging recent efforts by G-MW to strengthen the management oversight of trading conducted through Watermove, we consider that management oversight of non-Watermove trading activities remains inadequate. Not enough information is reported to the board for it to effectively oversee water trading activities, which carry substantial business risk. Business planning needs further development, as does the management of performance and risk.

## Recommendations

**Until such time that a single entity is responsible for managing water trading activities across the state, the following recommendations are made.**

6. **That G-MW develop a 3-year business plan (as well as an annual plan), with both plans:**
   - **covering all water trading activities and not just trading on Watermove**
   - **identifying how the achievement of outcomes will be measured**
   - **assigning responsibility for the achievement of outcomes and targets to its staff.**

7. **That G-MW:**
   - **expand its performance measures to cover all water trading activities managed by G-MW**
   - **clearly link the strategies in the Watermove business plan with the performance measures**
   - **establish systems and procedures to measure performance against established targets**
   - **develop a comprehensive policies and procedures manual covering all water trading.**

8. **That G-MW managers provide the board with sufficient information about all aspects of water trading for the board to adequately discharge its responsibilities.**

### RESPONSE provided by Acting Chief Executive, G-MW

*Goulburn-Murray Water partially agrees with recommendation 6. Goulburn-Murray Water believes that:*

- *the current corporate plan should include these measures*
- *a separate 3 year business plan would not add further value*
- *service related activities should be the focus, not market based activity.*

*Agree with recommendation 7, other than with the first dot point. The role of G-MW is to enable and facilitate trade, but not to influence the free functioning of the market. As such, measures should only relate to service based outcomes and measured by service-based performance indicators.*

*Recommendation 8 agreed.*

## 2.1.4 Were water rights, allocations and use accurately recorded?

Before the start of the irrigation season each August, the amount of available water in each river system is calculated by the responsible water authority.

An announcement is then made of the total amount of water to be provided to licence and water rights holders from each system. Because the amount of water available is usually greater than that needed to satisfy entitlement holders, they usually receive 100 per cent of their entitlement.

After that, enough water to meet the following season's water entitlements is reserved based upon volumes in storage and projected inflows. If there is more water available after this, it is offered for sale to licence and water rights holders or to other landowners (known as sales water). As explained in this article's background section, when demand for sales water exceeds supply, it is offered in the same proportion as each licence and water right holders share of the total entitlements of the system. That is, if a licence or water rights holder has one per cent of the water entitlements in the system, they are offered one per cent of available sales water.

That means that the water available to licence and water rights holders (their water allocation) is the total of:

- the volume of water specified in their water right and (or) licence (their water entitlement) that can be made available for supply
- any additional water that they are entitled to purchase (sales water).

In addition to their allocation, people can also buy water on the water market.

The amount of available water is regularly reassessed throughout the season, as weather conditions and water use affect the volumes of water in storage. If more water flows in, and less out, than predicted, the annual allocation is increased. Water authorities widely publicise changes to allocations.

Holders of water rights and licences can use their seasonal water allocation, sell or transfer all or part of their seasonal water allocation to another party, or sell part or all of their water right or licence permanently. Seasonal water allocations that are not used at the end of the irrigation season cannot be carried over to the next irrigation season.

In assessing whether licences and water rights, seasonal water allocations and use were accurately recorded across the state, we examined if:

- water entitlements were clearly defined and allocated
- there was a register containing all the information required by authorities to approve and transact water trades, which was accessible to them.

In assessing whether licences and water rights, seasonal water allocations and use were accurately recorded by G-MW, we examined if G-MW:

- had regularly and promptly performed key associated reconciliations
- ensured the reconciliations were independently reviewed by a senior official.

## Clear definition and allocation of water rights

Before the commencement of the *Water Act 1989*, the state government authorised water authorities to access water to supply the holders of licences and water rights. However, these authorisations did not specify the volume of water that could be used, or when it could be accessed. Since the Act was promulgated, these authorisations have been progressively replaced with bulk water entitlements to the respective water authorities.

Under the Water Act, about 80 per cent of the 5 000 gigalitres of water available for use (urban, industrial and rural use) in Victoria each year is allocated by the state government to water authorities as bulk water entitlements. This is a long-term average that cannot be guaranteed. However, bulk water entitlements have yet to be specified in the Act for the:

- Ovens and Broken systems (originally due for specification in 2002, now due by July 2004)
- mid-Loddon system (for which specification started in 2001, now due by June 2005)
- Tarago system (expected to be specified by August 2004)
- Yarra system (expected to be specified by August 2004).

Once these systems are specified, 90 per cent of all water available for use in the state will be covered by bulk water entitlements.

In the major irrigation districts, water entitlements are clearly defined and water use is metered and controlled to ensure it is in line with seasonal water allocations. However, the state also has some areas, usually on unregulated rivers and creeks, where use is not metered. In these circumstances, usage is periodically monitored by diversion inspectors.

Some of the water from these areas is taken by individuals who do have a entitlement to the water. At least one authority (G-MW) is working to prevent this happening, by gradually identifying long-term but unlicenced users and issuing them with licences or water rights.

Because of the significant cost to small land holders of buying meters to measure their water use, G-MW assumes these land holders will annually consume an volume of water, based on the size of their land holding and their land use. G-MW is also conducting a metering program for all significant water use in unregulated systems.

### Conclusion

Finalisation of the specification of bulk water entitlements should be a priority. If water is not clearly allocated, it cannot be effectively managed or traded. We encourage DSE to complete this process as quickly as possible.

It is also important to formally recognise water use in unregulated systems, which have not been previously subject to water licences. This should also be done as a priority, so that all water usage is regulated.

While we accept that requiring all landholders to meter their water usage may burden some small landholders, we nevertheless consider that authorities further investigate a way to periodically check that water usage is in line with seasonal water allocations.

## Entitlement register

The *Water Act 1989* requires rural water authorities to maintain registers to record water rights in irrigation districts, which creates an irrigator's right to access water. Rural water authorities also keep a record of water licences issued by them. G-MW records water rights and licences in the same register.

Entitlement registers record details of water entitlements, seasonal water allocations, changes to allocations made during the season, the water used[3] and water bought and sold on the water market.

As each rural water authority has developed their entitlement register independently of other water authorities, there are now 5 different systems and procedures, which perform the same functions.

The Murray Darling Basin comprises linked river systems in southern Queensland, most of New South Wales, northern Victoria and eastern South Australia. Within the basin, water is traded across state boundaries, as well as within states (including between Victorian water authorities). One register recording all water entitlements in the basin may increase the efficiency of the market and trading processes.

Before water is traded, the water authority which currently supplies water to the person who wishes to sell, checks that the seller has the right to the volume of water they are offering for sale. The water authority, which will supply water to the buyer, checks that:

- it can deliver the water (that is, that its pipelines and other infrastructure are adequate to supply the water)

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[3] Water usage is first recorded in an operations register and then transferred to the entitlement register.

- the buyer has the right to use the water on the land to which the water will be delivered
- the transfer will not have adverse environmental consequences.

Confirming a water trade can take some time, with consequent financial risks, because of the time taken to access separate records held by the supplying authorities, relating to their capacity to deliver the water and the right to use the water on a specified land holding.

At the time of the audit, all the information required to approve water trades was not incorporated into one register.

## *Conclusion*

If there were fewer entitlement registers in the state, the recording and management of water trading would be more efficient, and there would be no need to reconcile transactions between authorities.

To rationalise the state's entitlement registers, DSE could consider facilitating either:

- a single register for the whole state
- 2 registers, broadly based on the state's 2 major river systems (with one register for the north of the state and one for the south)
- a single entitlement register (or electronic linking of state registers) to cover the entire Murray Darling Basin, following consultation with other states.

As indicated earlier in this article, entitlement registers should be made available to the public.

### Recommendations

9.    That either a single statewide register or individual registers maintained by water authorities, hold all the information required to approve a water trade.

10.   That DSE discuss with its counterparts in New South Wales, Queensland and South Australia the possible establishment of a single entitlement register (or electronic linking of state registers) for water traded in the Murray Darling Basin.

*RESPONSE provided by Acting Chief Executive, G-MW*

*Recommendations agreed.*

## Reconciliations conducted by G-MW

DSE requires authorities to reconcile, at the end of each month, the closing balance of the entitlement register for the previous month with the closing balance for the current month, taking into account the month's trades (recorded separately). This month-to-month reconciliation is intended to identify and bring to the attention of management instances where trades have not been correctly recorded in the entitlement register.

G-MW was not conducting this reconciliation.

DSE also requires authorities to reconcile, at the end of each month during the irrigation season, the seasonal water allocations recorded in the entitlement register to the total seasonal water allocation for each river system, as declared by the authority. If seasonal water allocations are not correctly recorded in the entitlement register, licence and water rights holders will have access to more (or less) water than the amount to which they are entitled. The month-to-month reconciliation is intended to identify situations where approved water allocations have not been accurately recorded in the entitlement register and bring this information to the attention of management so that appropriate corrections can be made.

Any error would almost certainly affect all licence and water rights holders in a river system, and thus be quickly identified and corrected by the authority. However, it may also lead to a licence and water rights holder (who believed the information in the register to be correct) inadvertently selling or using water to which they had no right.

G-MW was also not conducting this reconciliation.

Further, G-MW does not reconcile its water usage records with its entitlement register. In the absence of this reconciliation, it is possible for entitlement holders to use more water than have been allocated or sell water they have already used.

### *Conclusion*

Reconciliations are essential internal controls, which identify and bring to the attention of management:

• instances where other internal controls are not operating

• errors or irregularities in information recorded

• non-compliance with legislation, government policy and agreements between governments.

These reconciliations were not being conducted at G-MW.

**Recommendation**

> **11.  That G-MW conduct monthly reconciliations of the entitlements register to the:**
>
>   • **month's water trades (and of the trading register to the general ledger)**
>
>   • **total seasonal water allocations for each river system**
>
>   • **records used to record water usage.**

***RESPONSE provided by Acting Chief Executive, G-MW***

*Recommendation agreed.*

## 2.1.5  Were systems and procedures to manage and record water trades adequate?

Rural water authorities approve all trades. The Act requires authorities to approve water trades into and out of irrigation districts and the Minister has delegated to authorities the power to approve the transfer of licences.

Water trading is regulated by a formal set of rules and requirements, which are contained in:

• the *Water Act 1989*

• the Water (Permanent Transfer of Water Rights) Regulations

• the Murray Darling Basin Agreement

• ministerial guidelines

• departmental requirements

• water authority by-laws and policies.

These trading rules relate to both permanent and temporary trades, trade in bulk water entitlements, interstate trades and net movements of water out of irrigation districts. The rules are primarily designed to ensure that the trades:

• are physically possible

• do not impact on other water users, such as affecting the timeliness of their water delivery

• do not have an adverse impact on the environment (mainly salinity and drainage impacts) where water is used in new locations

• planning and other approvals are obtained for new developments.

The rules are also designed to protect the legal rights of individuals who may be affected by the trades and to adjust the rates at which water is exchanged, to account for water losses or water moving between systems with different reliability of water supply.

In assessing whether authorities' systems and procedures to manage and record water trades were adequate, we focused our attention on G-MW, including its interface with other water authorities, to determine if:

- water trading documentation was adequate
- authorities promptly updated their water entitlement registers, and that trading procedures and information were consistent across authorities.

In assessing whether G-MW's systems and procedures to manage and record water trades were adequate, we examined if the authority had sound internal controls.

## Adequacy of trading documentation

The Water (Permanent Transfer of Water Rights) Regulations prescribe a standard form which is required to be used to transact permanent water trades. However, each rural water authority has independently developed its own documentation for recording temporary water trades.

The use of different forms (particularly when trading involves more than one authority) makes the trading process administratively more complicated and confusing for market participants than it needs to be.

Standardised accountable documentation and procedures for water trading across the state would greatly simplify the trading process and would help ensure that the accuracy of rights registers is maintained.

### Recommendation

12.  **That DSE require all water authorities to use the same accountable documentation to record water trading transactions.**

*RESPONSE provided by Acting Chief Executive, G-MW*

*Recommendation agreed.*

## Updating of registers and consistency of trading information

If the entitlements of both buyers and sellers are not updated in the entitlements register at the same time after a trade, the register can show that both parties (or neither) have a right to the water. That means both parties could access part or all of the water traded. This situation is further complicated, and more likely, where trades involve more than one authority, because both authorities need to update their records at the same time to avoid cut-off difficulties.

There have been instances where the entitlements of buyers and sellers were not promptly updated following a water trade, particularly where the trade involved more than one authority.

Each authority has developed its own entitlements register. The information collected, the trading procedures used and the information reported to DSE by each authority varies. These differences make it difficult to provide reliable statewide statistics for water trading, and to ensure that registers accurately and promptly record details of trades across authorities.

Differences in trading procedures and information reporting may partly explain the inability of G-MW and Sunraysia Rural Water Authority to reconcile water trades between the 2 authorities in 2002-03, and in the previous 2 financial years. The discrepancy in 2002-03 was 10 714 megalitres. DSE considers that the discrepancy was likely to be due to the water authorities using different transfer dates to record water sales.

The risks of trades between authorities not being reconciled is that sellers will be given access to water that they have already sold, and that fraudulent water trades will go undetected.

Inconsistent procedures for water trading, and unreconciled balances between authorities, may have delayed the discovery of a major water rights fraud in the late 1990s. In 2000, a licence administrator of one rural water authority was convicted and jailed for selling about 500 ML of water rights that did not exist. The value of the fraud was estimated at $1 million.

## Recommendations

**13. That DSE require all water authorities to adopt the same procedures for executing trades and updating entitlements registers, which hold consistent information.**

**14. That all water authorities comply with DSE's requirement to regularly reconcile inter-authority trades.**

*RESPONSE provided by Acting Chief Executive, G-MW*

*Recommendations agreed.*

## G-MW's internal controls

### Segregation of duties

Before water is traded, G-MW's procedures require a staff member to check the entitlements register to ensure that the seller has enough water allocation to trade. Currently, G-MW staff who process trades (either through Watermove or private trades) also amend the entitlements register after the trade.

The risks of the same staff member both processing trades and amending the entitlements register are that they could:

- amend the register to increase the seasonal water allocation of a licence or water rights holder, then sell the extra allocation to a third party
- identify a licence or water rights holder who had not used their seasonal water allocation, and sell water up to the amount of the unused allocation to another party.

These risks may be mitigated by management oversight of transactions. However, we saw no evidence of such oversight.

## Recommendation

**15. That all rural water authorities not allow staff who process water trades to amend entitlements registers.**

### RESPONSE provided by Acting Chief Executive, G-MW

*Recommendation agreed.*



*Regulator minor outlet at Waranga basin.*

### *Limits on water trades*

When water trading first started, irrigators and some authorities were concerned that water entitlements would be traded out of their area, leaving irrigation districts with a customer base so reduced as to no longer be able to maintain their water infrastructure. Irrigators were concerned that water authorities would then either:

- increase fees paid by the remaining licence and water rights holders, or
- close down infrastructure that was no longer financially viable.

The state government subsequently restricted the movement of water to minimise the impact of the potentially negative consequences of water trading on local communities. Regulations pursuant to the *Water Act 1989* allow the seller's water authority to refuse a trade if it would mean that the net trade out of that irrigation area in any year exceeded 2 per cent of the water rights in that area.

This restriction has prevented trade in only a few areas since being introduced. It has tended to defer trade to the following year, rather than to stop it.

G-MW monitors the level of water trades and prevents the net volume of water traded from exceeding the 2 per cent limit. However, the 2 per cent limit was breached in 2 irrigation areas (Pyramid Hill/Boort and Rochester) in 2003-04. These breaches occurred because G-MW approved water trades without first checking that the transfer did not breach the 2 per cent limit.

The occasional breaching of the 2 per cent limit indicates that G-MW needs to improve its procedures for approving water trades.

### *Penalty interest*

After a transaction is completed, the buyer has 7 days to pay for the water (and a trading fee). The seller also pays a trading fee. Watermove established a rule that penalty interest must be paid on all overdue amounts. However, authority staff did not consistently apply this rule, but exercised discretion as to if and when penalty interest was charged on overdue accounts.

Discretionary application of the penalty interest rule results in inequitable and inconsistent treatment of buyers and sellers. Also, when penalty interest is not charged, traders have no incentive to promptly pay amounts owing to the authority.

### Recommendation

> **16.  That G-MW consistently applies the penalty interest rule on all overdue amounts.**

*RESPONSE provided by Acting Chief Executive, G-MW*

*Recommendation agreed. Goulburn-Murray Water believes that it is applying penalty interest consistently.*

## Computerised controls over recording of water entitlements and water trading

G-MW systems (including Watermove) had computerised controls to protect the confidentiality, integrity and availability of data. Our review of these controls found that:

- security controls over the data and software in the trading systems were inadequate in some areas, particularly in relation to access controls, logging and monitoring of security activity

- G-MW's processes for upgrading software could be improved. In particular, we considered that changes to systems and applications should be more formalised and controlled

- the risk of processing error increased because of the use of manual data entry to transfer information between systems, rather than through automated links.

### Conclusion

Given the importance of water trading and the risk associated with these activities it is important for G-MW's computerised controls be of a high standard. We did not find this to be the case.

### Recommendation

> **17.  That computerised controls over G-MW's water trading systems be strengthened.**

> *RESPONSE provided by Acting Chief Executive, G-MW*

> *Recommendation agreed.*

## Integrity of water trading data

In assessing the completeness and accuracy of the data recorded in G-MW's entitlements register during 2003-04, we used computer-assisted audit techniques to identify instances of:

- non-compliance with trading rules

- unusual or abnormal items (such as duplicate transactions)

- poor data quality.

Where anomalies were identified, a sample of these items was examined in detail to determine their cause.

Instances were identified where transactions were deleted from the entitlements register after they had been processed. This was allowed by the trading system to correct errors. However, once cancelled, the system retained no record of the transaction. There was also no formal approval of these cancelled transactions.

In addition, we identified instances where licence and water rights holders had used more water than they were entitled to. This over-usage ranged from one ML to over 200 ML. This situation arose primarily as water meters are only read on a few occasions during the irrigation season, and it is only after these meters are read that the authority becomes aware of the overuse.

In these circumstances, the authority's procedure is to restrict any further use or sale of water until the licence and water rights holders' water balance is returned to the positive. This is generally achieved by the licence and water rights holder purchasing water on the water market. The authority also has the capacity to charge entitlement holders who have negative water holdings an overuse fee, although we were advised this option is rarely used.

Further analysis of specific cases of water overuse indicated that:

- In a number of cases, the overusage of water was not corrected by the licence and water rights holder purchasing water on the market, for a number of months. While controls had been established to stop further use or sale of water after any overuse was identified, these controls did not always work.

- Allowing licence and water rights holders to address their water overuse at the end of the irrigation season benefited them, as the purchase price of water on the market reduced as the season progressed.

- Where water overuse was not significant (less than 2 ML), licence and water rights holders were generally not required to purchase water on the market to rebalance the deficiency.

- In some cases, information on water usage was incorrectly recorded in the rights register. These errors were corrected following identification by audit.

Deficiencies were also identified in the quality of data held in Watermove and the entitlements register, including:

- multiple customer records relating to the same customer (or trader)
- inconsistent approaches to recording certain data (such as contact details)
- transactions recorded in the wrong year
- instances of certain data incorrectly recorded within the system (such as ABN numbers).

While the data quality issues identified do not represent a significant weakness in the system, they reduce the ability of staff to detect unusual or anomalous transactions.

## Conclusion

While our audit testing did not identify any fraudulent transactions, the results of our audit work suggest that there are shortcomings in the control framework and in the accuracy and completeness of information recorded by G-MW in its information systems.

The data quality issues identified also support our earlier conclusion that water trading controls generally need to be improved.

## Recommendation

18. **That G-MW:**
    - **change its water trading system and related procedures to ensure that the system maintains a record of all cancelled trades, and that transactions cannot be cancelled without formal approval**
    - **read water meters more frequently, especially towards the end of the irrigation season where the seasonal water allocation has nearly been consumed**
    - **review its procedures dealing with overuse of water to ensure that action is taken so that licence and water rights holders rectify any overuse as soon as possible**
    - **charge entitlement holders an overuse fee, where their actions to address the overuse of water are not timely or the licence and water rights holder is a repeat offender**
    - **investigate data quality issues identified by audit and take appropriate action to prevent future recurrence**
    - **conduct periodic reviews of key data within the water trading systems to identify and correct any errors in recorded data.**

*RESPONSE provided by Acting Chief Executive, G-MW*

*Recommendation agreed.*

## 2.1.6 Were G-MW's systems and procedures to prevent and detect fraud adequate?

Water trading is more susceptible to fraud than trading in most other commodities, because:

- volumes of water are not fixed or easily identifiable (so it is less likely that stolen volumes would be noticed and reported)
- the annual allocation is an option to use water only for 12 months (so it is unlikely that unused seasonal water allocations at the end of the year that were illegally accessed would be noticed).

Water trading is also more susceptible to fraud because:

- water markets are relatively new and undeveloped
- the small size (and staff capacity) of some authorities makes it difficult for them to adequately segregate duties
- water authorities both provide water and register the rights to it, which creates a potential conflict of interest.

Individuals can commit fraud by:

- unauthorised altering of authority records
- selling water entitlements they do not own
- using inside information about water allocations in their trading decisions.

The primary responsibility for preventing and detecting fraud rests with the boards of authorities. Boards must oversee management to ensure:

- the integrity of recording and reporting systems
- that risk is managed, there are adequate controls and that laws and regulations are complied with.

In assessing whether G-MW's systems and procedures to prevent and detect fraud were adequate, we examined if the authority had:

- a fraud management strategy
- procedures to guard against fraudulent trading, including insider trading.

The authority did not have a fraud management strategy.

The authority had procedures to prevent the misuse of inside information. We found no evidence of the use of inside information to profit from water trading.

## Recommendations

19.  **That G-MW develops a fraud management strategy for water trading, as part of a broader risk management strategy for the whole authority. Responsibility for developing and implementing the strategy should be assigned to a senior officer, and the strategy should provide for the identification, analysis, evaluation and management of the risk of fraud.**

20.  **That authorities guard against the misuse of inside information by promptly releasing full information about the way that changes to seasonal water allocations are calculated, and the data used in calculations.**

*RESPONSE provided by Acting Chief Executive, G-MW*

*Recommendations agreed.*

### RESPONSE provided by Secretary, Department of Sustainability and Environment

*The government has for some years been concerned about the integrity of water trading processes and records. In 2000, an officer of one rural water authority was jailed for fabricating and selling water entitlement. Two authorities' records of the trade between their customers could not be easily reconciled, because the authorities used different dates for the same trades.*

*As a result, the authorities have been asked and have agreed to use the same date for each trade; to have monthly reconciliations of trade and changes in entitlement registers, and of seasonal allocations of water and the sum of allocations available to water users; and to separate the roles of processing officer and authorising officer.*

*In mid-200, the then Minister for Conservation and Environment requested that the Auditor-General undertake or arrange an annual audit of the trading records and entitlement registers of each of the five rural water authorities. The Auditor-General agreed that such audits were a logical extension of the existing, financial audits that the Auditor-General arranged.*

*The Auditor-General has now provided a report that ranges widely over water trading arrangements, and then focuses on one authority.*

*The department generally supports the recommendations put forward in the report. The department is disturbed that monthly reconciliations are not yet being undertaken by Goulburn-Murray Water, and that authority staff who process trades are still also updating the entitlement register.*

*On 23 June 2004 the government released its White Paper on water, setting out a far-reaching plan for reform. The plan includes strengthening the boundaries between consumptive resource and environmental water, and extending metering of use and compliance with entitlements – all rightly recognised by the Auditor-General as important to the water market.*

*The government proposes to separate out the key components of an individual water user's entitlement: a share of available water, a share of delivery capacity, and a licence to use water on some land. This 'unbundling' will require a major upgrade to entitlement registers.*

*The government has accordingly allocated funds for developing a single, web-based public register of all water-related entitlements. Registers have long been pivotal for authorities that are responsible for supplying farmers' rights, and the authorities will remain accountable for relevant parts of the new register, but there will also be central supervision and control.*

### RESPONSE provided by Secretary, Department of Sustainability and Environment - *continued*

*Trading procedures will be further standardised. For example, it is proposed to require that the trading price be declared on a form signed by both buyer and seller; this will eliminate an avenue for broker malpractice, and will be the basis for improved market information. The new system will facilitate publication of an annual report on water trading (indeed, this will be part of water accounts that track not only rights, but flows and use across the state).*

*While this trading report should certainly be audited, it will be at least two years before we move from the existing authority registers. The department believes that it is important, during this period, for the Auditor-General to proceed with annual audits of the trading records and entitlement registers of each of the rural water authorities, together with relevant protocols.*

*The department agrees with the Auditor-General's suggestion that the results and recommendations of his current report, which are broadly consistent with the White Paper plan, be considered as this plan is implemented.*

*The Auditor-General proposes complete segregation of some functions, moving them to agencies other than water authorities to avoid potential conflicts. However, this is one area where the situation can be complex and the department is not yet persuaded that the benefits would always outweigh the costs.*

*For example, his report suggests that authorities supplying water should not have a role in processing and recording trade, because they may be reluctant to encourage trade since rights moving outside their areas could cut their revenue. In fact, authorities have an interest in encouraging trade, because it lifts the profitability of their customers. The regulations, which are set by Governor-in-Council not the authorities, do not allow authorities to stop trade out of their areas if it is less that two per cent of rights per year.*

*The government is about to upgrade the recording of trades through development of the new water register, which (as noted above) will involve supervision by an agency outside authorities.*

*The other potential conflict mentioned, is that water authorities that process and record water trades may wish to expand irrigation in their areas and so may not be as conscientious as they should be in monitoring and ensuring compliance with environmental regulations. Again, authorities are just administering rules established by broader processes (with involvement of catchment authorities, the EPA, and, for salinity in the Murray-Darling Basin, other states). Regulating irrigation practices on the ground entails metering water, which the authorities must do anyway for other reasons (indeed, they own the meters).*

*The department accepts that periodic checking of authorities' administration of water-use licensing, including compliance with overarching frameworks and plans, could be beneficial.*

## 2.2 Management of procurement and accounts payable

### 2.2.1 Audit conclusion

We found the procurement and accounts payable functions in those agencies subject to review to be adequate. Although a number of recommendations have been made as a result of our audit, the overall conclusion is that those agencies subject to review:

- had adequate controls (manual and automated) over the procurement and accounts payable functions
- complied with legislative requirements.

A strength noted in the current procurement environment is the requirements of the Victorian Government Purchasing Board. We found these requirements to be highly effective and recommend that consideration be given to broadening the range of agencies subject to them.

Agencies have indicated that the requirements for the disclosure of contracts over $100 000 are somewhat unclear, in particular in relation to contracts entered into under legislation other than the *Financial Management Act 1994*. This uncertainty detracts from the otherwise clear guidance and compliance in relation to the disclosure of major contracts.

In relation to the paying of accounts, many instances were noted where agencies did not complete purchase orders prior to the acquisitions of goods. The approval of orders after the acquisitions increased the risk associated with the management of commitments.

Agencies met supplier terms in the majority of cases, however, the level of non-compliance with terms was still significant. In an environment where electronic funds transfer is an efficient and effective payment method, it was also disappointing that 40 per cent of payments are still being made by cheque. The use of mail to inform suppliers that payment has been made in 90 per cent of cases adds unnecessarily to the cost of paying accounts. Agencies need to investigate whether this can be achieved electronically.

Recommendations included in this report will assist in reducing the above problems in the future.

## 2.2.2 Background

In 2003-04, the Victorian general government sector expected to spend $10 700 million on goods and services (including asset procurement such as property, plant and equipment). Procurement and payment are major points of contact between government and business, with very significant financial implications for both.

Under the *Financial Management Act 1994*, the *Local Government Act 1988* and ministerial direction, public sector agencies are required to implement and maintain effective internal controls over the procurement of goods and services, and over accounts payable. These requirements set the minimum standards for agencies.

The Victorian Government Purchasing Board (VGPB) was established in 1995 to (among other things):

- establish goods and services procurement frameworks to be applied by departments and administrative offices
- monitor compliance with supply policies and ministerial directions, and report irregularities to relevant ministers.

All government departments and administrative offices must follow the VGPB's policies[4]. Statutory entities and other government businesses are not required to do so, but may choose to apply the VGPB's policies rather than develop their own. The *Financial Management Act 1994* and other legislation set down minimum requirements for agency procurement functions.

To ensure greater transparency, the government has required government departments and administrative offices to register all open and closed public tenders on the Victorian Government Tenders System. These details are disclosed at <www.tenders.vic.gov.au>. The requirements also include the publication of details of contracts entered into on the Contracts Publishing System. These details are disclosed at <www.contracts.vic.gov.au>.

Related to the procurement function is the payment of accounts. Once a decision to procure goods or services has been made, the verification of the receipt of goods or services and payment to the supplier becomes necessary. The accounts payable function is a key compliance function of all agencies. Rapid changes in technologies have provided opportunities for efficiency gains in the payment of accounts, while also creating a range of new risks associated with the function.

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[4] In addition to departments, the following agencies must comply with VGPB policies: Victoria Police, Victorian Auditor-General's Office, Office of Public Prosecutions, Office of the Chief Commissioner of Police, Office of the Ombudsman, Office of Public Employment, Essential Services Commission, Office of Legal Ombudsman, Victorian Electoral Commission and Office of the Privacy Commissioner.

## Purpose of the audit

Procuring and paying for goods and services are core activities of public sector agencies. Procurement activity by agencies has more than doubled in the last 5 years.

The purpose of this audit was to establish if agencies:

- had adequate controls over the purchasing function
- procurement and payment of accounts complied with applicable legislative requirements.

While the methodology allows for conclusions to be made about the procurement and accounts payable functions of the agencies audited, the issues raised may also be worthy of consideration by other agencies.

## Methodology

The audit was undertaken in 3 stages:

- consideration of accounts payable and procurement matters noted in previous financial statement audits
- a questionnaire survey of 18 agencies (including all major departments), to gather detailed information about their procurement and accounts payable functions
- a detailed review and examination of information and selected transactions from 6 agencies.

Figure 2.2A lists the agencies surveyed and the 6 agencies that were examined in detail.

**FIGURE 2.2A: AGENCIES SURVEYED AND EXAMINED IN DETAIL**

| Survey group | Detailed examination group |
|---|:---:|
| Central Highlands Region Water Authority | |
| City West Water Limited | ✓ |
| Department of Education and Training (a) | |
| Department of Human Services (a) | |
| Department of Infrastructure (a) | |
| Department of Justice (a) | |
| Department of Premier and Cabinet (a) | |
| Department of Primary Industries (a) | ✓ |
| Department of Sustainability and Environment (a) | ✓ |
| Department of Treasury and Finance (a) | ✓ |
| East Grampians Health Service | |
| Greater Shepparton City Council | ✓ |
| Melbourne University Private Limited | |
| Office of Chief Commissioner of Police (a) | ✓ |
| Parliament of Victoria | |
| Victorian Arts Centre Trust | |
| Victorian Urban Development Authority | |
| Victorian WorkCover Authority | |

(a)  Agencies required to comply with VGPB policies.

## 2.2.3  Did agency procurement practices meet requirements?

### Was external procurement guidance adequate?

In assessing whether the external procurement guidance available to agencies was adequate and timely, we examined if:

- external procurement guidelines were readily accessible to all government agencies
- external procurement guidelines were regularly reviewed and updated.

The main external sources of procurement guidance for agencies were VGPB policy and guidance (including guidance about ethical purchasing), the Financial Management Act (and associated directions and standing orders) and the Local Government Act (including best value requirements). All these sources were readily accessible through the internet.

The Department of Treasury and Finance's web site <www.dtf.vic.gov.au> provides detailed information about the requirements of the Financial Management Act, associated regulations and directions, and contemporary approaches to purchasing. This information includes the Directions of the Minister for Finance, which incorporate requirements for procurement and expenditure. These requirements apply to all agencies operating under the Financial Management Act.

The VGPB's web site <www.vgpb.vic.gov.au> provides policy and guidance about procurement planning, tender and quotation requirements, evaluation and selection of suppliers, approval and notification processes, example contracts and contract management procedures.

VGPB procurement policies provide minimum standards for procurement of non-construction goods and services by departments and administrative offices. Unlike the Directions of the Minister for Finance, the VGPB requirements only apply to a small proportion of the agencies operating under the Financial Management Act.

The Department for Victorian Communities' website <www.dvc.vic.gov.au> provides detailed information about the requirements of the Local Government Act. It also had information about best value requirements, and about compliance reviews that are required to be conducted by local government agencies.

All the website information was comprehensive and up-to-date, and had links to other useful information. All the websites gave contact points for further information.

### Conclusions

The 3 websites reviewed were generally easy to navigate. The content was not difficult to find, nor hard to read. There was enough detail to satisfy all the general questions that users might ask.

External guidance and policies about procurement are adequate, being readily available, comprehensive and up-to-date.

As only a small proportion of agencies are required to comply with VGPB policies, a risk exists that inconsistent policies and practices will be developed throughout the public sector. The development of separate policies by each agency may also be inefficient.

## Recommendation

21. **That the Department of Treasury and Finance consider broadening the requirement to comply with VGPB policies and practices to all agencies operating under the Financial Management Act.**

### RESPONSE provided by Secretary, Department of Treasury and Finance

*For DTF to require all Financial Management Act 1994 (the 'Act') entities to be bound by VGPB procurement policies, it will entail:*

- *a change in the Act to broaden the function of the VGPB. At present, Section 54B of the Act only refers VGPB functions as they relate to the supply of goods and services to departments*

- *a change to VGPB membership to include representation by agencies*

- *the Minister for Finance agreeing to be responsible for outer-budget agency procurement activities.*

*The legislative and operational implications of pursuing this recommendation will require careful consideration, including the issue of VGPB governance and independence for some of those agencies.*

### RESPONSE provided by Chairman, Victorian Government Purchasing Board

*The Board supports this recommendation. It is aware that Cabinet has previously resolved that all agencies not covered by VGPB policies should benchmark their procurement policies and practices against the Board's policies and an extensive communication exercise was undertaken to increase the awareness and understanding of these policies.*

*Extending the reach of VGPB policies could have a positive impact cost-benefit for the procurement activities of the Victorian government and taxpayers. The Board's policies do comprehend considerable delegations to agencies at 4 levels of accreditation. Action on the recommendation would have resource and legislative consequences and any impact on the independence and efficiency of some agencies would need to be considered as part of implementation arrangements.*

## Was internal procurement guidance adequate, and consistent with external requirements?

Agencies are required to have detailed internal policies and procedures to ensure that the minimum standards set by external requirements are met (and preferably exceeded).

In assessing whether the internal procurement guidance was adequate and consistent with external requirements, we examined if:

- agencies had internal policies and procedures for procurement
- policies and procedures were consistent with external requirements.

All surveyed agencies (except 2) had documented procurement policies and procedures.

Half the agencies surveyed were required to comply with VGPB procurement requirements. The internal policies and procedures of these agencies specifically referred to VGPB requirements.

All agencies that had documented policies made them readily available to staff. In most instances, policies were available on agency intranets. This enabled agencies to quickly revise information to ensure it stayed current.

The agencies reviewed:

- had internal policies that adopted the principles of the external requirements
- required internal reporting of procurement breaches
- had standard forms and templates, procurement checklists, lists of frequently asked questions and procedures manuals.

Despite varying degrees of clarity, agency policies and procedures were readily available, easy to understand and comprehensively documented. There were 2 exceptions.

One agency surveyed had yet to develop policies about conditions of tendering, evaluation of tenders, evaluation of recommendation reports and preparation of specifications. The procurement policies of another agency were not documented.

## *Conclusions*

Sixteen of the 18 agencies surveyed had adequately documented internal procurement policies and procedures.

Despite quality variations, internal procurement policies and procedures, where they existed, were adequate and consistent with external requirements.

## Recommendation

**22. That agencies ensure their procurement policies and procedures are fully documented, to ensure that they can comply with external requirements.**

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

*DTF notes this recommendation.*

### *RESPONSE provided by Chairman, Victorian Government Purchasing Board*

*The Board welcomes the finding of the report that our requirements are sound and that there were no issues of non-compliance found. We support the recommendation and will assist in its implementation.*

*RESPONSE provided by Secretary, Department of Sustainability and Environment*

*Recommendation agreed. DSE's procurement policies and procedures are fully documented and available to all staff on the intranet.*

*RESPONSE provided by Chief Commissioner of Police*

*Victoria Police has well documented internal policies and procedures which are published on the organisation's intranet site. These policies and procedures are consistent with external requirements.*

*RESPONSE provided by Managing Director, City West Water Limited*

*City West Water has established documented policies and procedures.*

## Did agencies adequately review major purchasing projects?

Although the VGPB has established requirements and provides guidance for all procurements, it has specific requirements for major procurements. Such requirements include:

- preparation of tender documents
- tender complaint procedures
- quotations and public tender policies
- exemptions from public tender of purchases exceeding $100 000
- receiving and recording public tenders
- evaluation and selection policies
- approval and notification policies
- disclosure of contracts.

In assessing whether agencies adequately reviewed their major purchasing projects, we examined if:

- major purchasing projects were reviewed internally, and action taken to address any identified deficiencies
- the results of internal reviews were properly reported to the VGPB, where required
- the VGPB (if applicable) monitored departmental compliance with procurement policies and ministerial directions, and reported irregularities to the relevant minister.

Agencies subject to VGPB requirements are required to review and report their compliance with major procurement requirements in an annual supply report to the VGPB. This information is then included in the VGPB's annual report.

All agencies subject to VGPB requirements had reviewed their compliance with VGPB requirements and prepared an annual supply report for 2003. While the basis for selecting major procurements for review varied, all departments and administrative offices meet the minimum requirements of the VGPB.

The VGPB's 2003 report detailed a total of 29 breaches of VGPB major procurement requirements by all agencies subject to the guidelines (5.2 per cent of all major procurements). The most common breach was the commissioning of additional work against an existing contract without gaining the appropriate approvals.

There was no requirement for annual supply reports to be independently audited before being submitted to the VGPB. Nor does the VGPB undertake any processes to independently verify the information in the reports. Current legislative requirements restrict the power of the VGPB in this area to requesting departments to undertake an audit of their supply reports.

Agencies not subject to VGPB requirements do not have to formally review any of their procurement projects, or report to the VGPB (or any other body) about these.

Agencies not subject to VGPB requirements that we surveyed did audit some aspects of their procurement projects (such as delegated authority) every one to 3 years. However, they did not internally audit whole procurement projects.

The internal audit reports by agencies surveyed did not identify any major non-compliance or any significant matters.

As part of our audit we reviewed a range of contracts in the agencies subject to detailed review. No matters of non-compliance with either internal or external requirements were noted. This result was consistent with the findings of internal agency reviews.

## Conclusions

Reporting arrangements for agencies subject to VGPB requirements are sound. Notwithstanding the minor issues noted, agencies are generally complying with the external and internal requirements for major procurement activities.

The annual supply reports provide the basis for an effective review of high value internal procurement. The value of these reports could be improved through the incorporation of an independent review of the information submitted.

While reviewing aspects of purchasing on a periodic basis, agencies not subject to VGPB requirements do not adequately review their major procurement projects.

# Recommendations

**23.    That the Department of Treasury and Finance, together with the VGPB, establish arrangements to enable the VGPB to undertake audits or collect information from all agencies subject to their requirements.**

**24.    That those agencies not subject to the requirements of the VGPB audit all major procurements.**

### RESPONSE provided by Secretary, Department of Treasury and Finance

*DTF supports recommendation 23 in principle and will investigate broadening the role of the VGPB to include audits and/or collecting detailed purchasing data. Broadening the role of the VGPB will entail changes to the Financial Management Act 1994 (the 'Act')*

*Cabinet can confer the role of undertaking audits and extensive data collection on the VGPB in conjunction with, or as an alternative to changing the Act.*

*Under Section 54C(2)(d) of the Act, the VGPB already has the power to require accountable officers in departments and administrative offices to audit compliance with VGPB policies and ministerial directions and provide audit reports to the Board. Furthermore, the VGPB currently requires departments to submit annual procurement reports to determine compliance to procurement policies (rather than all procurement activities).*

*DTF also notes recommendation 24 in principle.*

### RESPONSE provided by Chairman, Victorian Government Purchasing Board

*The Board supports recommendation 23. Legislation currently restricts our audit role to asking departmental secretaries to conduct such audits. This recommendation has both legislative and resource implications and will necessitate discussion and agreement with the department and the minister.*

*The Board also supports recommendation 24 in principle.*

### RESPONSE provided by Secretary, Department of Sustainability and Environment

*Recommendation 23 agreed. It is DSE's understanding that the VGPB can undertake audits or collect information as part of its granting of accreditation to departmental APU's. We would express caution though that this function should not be over-audited, that is, subject to reviews by the VGPB, internal audit and external audit. It would be our suggestion that discussion should be held with each agency by each of the auditing parties to ensure that the timing of audits is conducted at reasonable intervals.*

> **RESPONSE provided by Managing Director, City West Water Limited**
>
> *The audit of major procurements will be undertaken as part of City West Water's internal audit program that includes the review of operational expenditure, delegation of authority and asset management - capital expenditure.*

## Were all major contracts disclosed in line with VGPB requirements?

The *Ensuring openness and probity in Victorian Government contracts* policy statement, issued in 2000, required information about all government contracts to be disclosed to the public. This only applies to those agencies required to comply with the VGPB policies.

The VGPB established the Contracts Publishing System (CPS) and made it publicly accessible through its website.

The Department of Premier and Cabinet guidelines *Openness and Probity in Victorian Government Contract - Implementation Guidelines,* required all departments to:

- report on the CPS summary details of contracts and standing offers for goods and services with an estimated value of between $100 000 and $10 million, within 4 weeks of them being signed
- disclose on the CPS the full text of contracts over $10 million (subject to *Freedom of Information Act 1982* criteria) within 4 weeks of them being signed
- disclose construction-related contracts over $100 000 (subject to disclosure requirements to be determined by the Minister for Planning).

Contracts may be exempted from the disclosure requirements if they contain information that would meet the exemption requirements of the *Freedom of Information Act 1982*. The secretary of the relevant department must approve these exemptions.

These guidelines were subsequently incorporated into VGPB requirements and reinforced by way of a financial reporting direction under the *Financial Management Act 1994*.

In assessing whether all major contracts were disclosed in accordance with VGPB requirements, we examined if the reporting requirements for non-construction contracts and standing offers worth between $100 000 and $10 million had been observed.

Our audit examined disclosures made by the Department of Treasury and Finance, the Office of the Chief Commissioner of Police, the Department of Primary Industry and the Department of Sustainability and Environment.

In general, the 4 agencies complied with the VGPB's requirements and the financial reporting direction. However, they inconsistently observed the requirement to disclose construction contracts. Two agencies disclosed all contract details, including construction contracts. The other 2 agencies did not disclose details of some construction-related contracts. They advised that they did not do so for 2 reasons.

First, they considered that these contracts were not subject to approval by the VGPB, or by their accredited purchasing unit, because they had been approved under other legislation (such as the *Project Development and Construction Management Act 1994*).

Second, VGPB requirements state that the Minister for Planning will issue a direction under the *Project Development and Construction Management Act 1994* requiring agencies to provide summary information on the CPS about construction-related contracts above $100 000. However, the minister has not yet given this direction. Accordingly, agencies considered that VGPB requirements were not clear about this matter and, as such, agencies could interpret the requirements differently.

Of the 4 agencies:

- Victoria Police had not entered any contracts onto the CPS for over 2 years. They asserted that all contracts entered into had been exempt for either commercial-in-confidence or for other reasons
- the Department of Treasury and Finance had not included one qualifying contract onto the CPS, asserting that it was commercial-in-confidence. However, the Secretary of the Department had not exempted the contract in accordance with requirements.

### Conclusion

While agencies generally had disclosed contracts in accordance with government requirements, inconsistencies in disclosure had resulted from their varying interpretations and understandings of the requirements.

### Recommendations

25. **That the VGPB (and other relevant agencies such as the Building Commission) liaise with the office of the Minister for Planning to prepare a direction about disclosure of construction-related contracts over $100 000.**

26. **That all agencies ensure that decisions to exempt contracts from disclosure on the CPS are adequately documented and authorised before the contract is approved.**

27. **That the VGPB require agencies to certify that all relevant contracts have been disclosed on the CPS, in their annual supply reports.**

**28.  That the VGPB facilitates the clarification and communication to all relevant agencies of the reporting requirements for contracts established under legislation other than the Financial Management Act.**

### RESPONSE provided by Chairman, Victorian Government Purchasing Board

*The Board is supportive of the intent underlying recommendations 25 to 28. The Board is prepared to assist the Minister for Planning in the preparation of a direction about the disclosure of construction related contracts. Our policies and practices will require that the CEOs of departments and agencies covered by our policies ensure that decisions to exempt documents from disclosure are documented before the contract is approved and that they certify that relevant contracts have been disclosed on the CPS in their annual supply reports. The Board notes that we do not have a responsibility for communicating contractual reporting requirements established under legislation which is not under our remit. Any extension of our responsibilities in this regard would require legislation or ministerial direction.*

### RESPONSE provided by Secretary, Department of Treasury and Finance

*DTF understands that the Building Commission is currently drafting a new direction regarding the disclosure of construction-related contracts and DTF may assist in its finalisation. However, the VGPB has no authority over construction-related contracts.*

*DTF also notes recommendation 26. The Government's "Openness and Probity in Victorian Government contracts – Implementation Guidelines (2000)" currently highlights that the CEO of an agency may direct in writing whether details of a contract are exempt matters under the Freedom of Information Act 1982.*

*In regard to recommendation 27, DTF will investigate such a requirement for annual procurement reports for the financial year 2004-05.*

*In regard to recommendation 28, DTF notes that the VGPB's responsibilities do not cover the:*

- *Project Development and Construction Management Act 1994*
- *Local Government Act 1988.*

*Clarification of the reporting requirements for contracts established under legislation other than the FMA are outside the VGPB's legislative mandate.*

### RESPONSE provided by Secretary, Department of Sustainability and Environment

*Recommendation 25 partially agreed. It was a government and DTF generated policy that required information on contracts with a value over $100 000 to be published. The VGPB implemented this in respect to purchases made under the Financial Management Act (1994). The Building Commission provides advice to the Minister for Planning with respect to ministerial directions issued under the Project Development and Construction Management Act (1994). It would therefore seem to be more appropriate for the Building Commission to raise this as a policy issue with the Minister for Planning. It should not be the role of the VGPB to negotiate arrangements with ministers in another portfolio.*

*Recommendation 26 agreed. DSE already ensures that decisions to exempt contracts from disclosure on the CPS are adequately documented and authorised.*

*Recommendation 27 partially agreed. Annual supply reports, now called annual procurement reports, require the reporting of any breaches of VGPB procurement policies (section 3.2). If contracts were not disclosed in accordance with the VGPB policy they should be disclosed in this section of the report. Appendix 4 to the Departmental Annual Report requires a statement that contracts over $10 million in value have been published.  In accordance with best practice, DSE also includes a statement that summary details for contracts between $100,000 and $10 million have been published. These controls with respect to publishing are considered sufficient.*

*Recommendation 28 partially agreed. DSE does not believe this is the role of the VGPB. They have been established under the Financial Management Act (1994) to undertake actions with respect to that particular Act. The ability for the VGPB to provide direction for contracts entered into under other legislation would seemingly require amendments to those Acts or a change in the VGPB's scope under the Financial Management Act.*

### RESPONSE provided by Chief Commissioner of Police

*Victoria Police confirms that the non-publication of contract details in accordance with VGPB policies was as a result of an administrative oversight. This has now been addressed. Policies and procedures have been established to incorporate provisions for disclosure as part of the approval process.*

## Did agencies comply with accredited purchasing unit limits?

The VGPB allows agencies to establish an accredited purchasing unit (APU). Each APU is delegated responsibility by the VGPB to oversee procurement processes and approve purchases within its accreditation limit, without reference to the VGPB. This allows major procurement activities to be streamlined and to draw on the experience and expertise within agencies.

As part of accreditation, the agency applies to the VGPB for an accreditation limit that suits the agency's needs and risks. The VGPB has 4 tiers of accreditation, ranging from Tier 1 ($1 million limit per purchase) to Tier 4 (unlimited value of purchase). The agency can apply to the VGPB at any time to vary its accreditation limit.

An agency must seek VGPB approval of the processes to be undertaken for any procurements that exceed its accreditation level.

We assessed whether procurements were within VGPB-approved accreditation limits.

Our audit examined in detail the procurement activities of the Department of Treasury and Finance, the Office of the Chief Commissioner of Police, the Department of Primary Industry and the Department of Sustainability and Environment.

We found that the 4 agencies complied with the VGPB accreditation limits. Where agencies planned to enter into a contract with a value that exceeded their accreditation limits, they had obtained VGPB approval.

While this audit did not find any breaches, agencies had reported several small breaches in their annual supply reports. These were mainly expenditures greater than the agency's approved limits. As required by the VGPB, agencies addressed breaches by advising senior officers of the breach, advising staff of correct procedures and taking steps to improve contract monitoring.

### Conclusion

With minor exceptions, agencies have made major procurements within VGPB-approved accreditation limits.

## 2.2.4 Were agency accounts payable functions adequate?

### Were agency procedures to authorise, certify and pay for procurements adequate?

To properly process transactions, agencies must have policies and procedures to authorise purchases, certify purchase documents and approve payments.

For these policies and procedures to be effective, an agency needs adequate "environmental controls". These cover the whole accounts payable function, and include matters such as who can access the system and key files, and the level of review and performance management.

One important environmental control is segregation of authorisation, certification and approval functions. If these functions are combined, one individual would be able to record and process a complete transaction. Segregation reduces the risk of error or intentional manipulation.

In assessing whether agency procedures to authorise, certify and pay for procurements were adequate, we examined if:

- there were adequate financial delegations
- procurements were properly authorised, certified and paid for
- the functions were segregated
- access was adequately controlled
- the accounts payable function was adequately reviewed.

The majority of agencies surveyed had financial delegations that were reviewed regularly and approved by management. Delegations in all but one agency limited either the value of individual transactions, or the budgets, that individuals could authorise up to. One agency surveyed did not specify the maximum dollar amount that a delegated officer could authorise.

The audit identified breaches of delegation limits in 2 agencies. These agencies did not have systems to prevent, before expenditure was incurred, authorising officers from exceeding the limits of their authorisations.

Figure 2.2B shows that between 11 per cent and 23 per cent of expenditures by the agencies reviewed[5] did not have an appropriately authorised purchase order raised before being incurred. We examined all purchases in the selected agencies (requiring a purchase order) with a purchase date between 1 July 2003 and 29 February 2004. It shows the number of transactions for which the date of the purchase order was later than the date of the invoice; and the percentage of these transactions to total transactions by the agency (requiring a purchase order) during the period. It also shows the value of these transactions, and the value of these transactions as a percentage of total agency transactions during the period.

**FIGURE 2.2B: RATE OF EXPENDITURE WITH LATE PURCHASE ORDERS**

| Agency | No. of transactions | % | Value ($'000) | % |
|---|---|---|---|---|
| City West Water | 569 | 23 | 3 297 | 48 |
| Department of Primary Industries | 9 472 | 23 | 29 003 | 18 |
| Department of Sustainability and Environment | 7 625 | 19 | 88 448 | 17 |
| Department of Treasury and Finance | 222 | 11 | 4 608 | 17 |
| Victoria Police | 9 014 | 15 | 15 044 | 15 |
| **Total** | **26 902** | **18** | **140 400** | **18** |

[5] Except for the Greater Shepparton City Council, for which information was not available.

A number of reasons can exist for a purchase order not being raised prior to the expenditure being incurred and many of these do not detract from the overall level of control over the purchasing function. However, the extent of subsequent raising of the purchase order means that the commitment information within the accounts payable system is not likely to be reliable. These weaknesses can be overcome through the raising of standing orders to cover expenditure where it is not practical or appropriate to raise a purchase order to meet each individual transaction.

Certification is the process of matching goods, delivery dockets, purchase orders, and invoices, and certifying all are correct before payment is made. If agencies use electronic purchasing and payment systems, certification may trigger automatic payment to the supplier.

Almost all agencies surveyed did not process an invoice or make a payment unless they had received a tax invoice. However, in a small number of instances, agencies did not have a tax invoice on file to support a payment, although payment had been made. In most instances, a supplier statement had been used in lieu of a tax invoice. However, incidents were found where withholding tax payments, in accordance with GST legislation, had not been made in circumstances where a tax invoice had not been received.

All agencies reviewed had paid some invoices more than once. The frequency of duplicate payments was very limited. All identified duplicate payments had been certified as correct, before payment was made. In all instances, the duplicate payments had been discovered, often by the supplier. The audit indicated that the frequency of duplicate payments did not represent a significant problem. However, as duplicate payments can be a means of gaining a fraudulent benefit, it remains important to focus efforts on reducing errors in this area.

Contributing factors to duplicate payments were:
- the ability to override controls in payments systems that were intended to detect duplicate payments. This was typically done by adding a "1", or an "a", to an invoice number (so that supplier invoice 1234 would be entered as 1234a)
- raising an additional purchase order after the receipt of a replacement or reminder invoice
- payment on replacement or reminder invoices as well as of originals. Replacements or reminders having been issued by the suppliers after the originals were delayed, or thought to be lost.

All agencies had clear policies and processes for approving payments. Neither this audit nor the most recent financial statement audits found any significant problems with the approval of accounts for payment.

The information technology controls of the agencies reviewed were operating effectively. Generally, access to their accounts payable systems was controlled by senior officers. Changes to master files[6] were made only by authorised people. There were password restrictions, and employees' profiles had different access levels, depending on their job responsibilities.

However, our audit, and recent financial statement audits, identified several weaknesses in controls. These included:

- no delegation limits incorporated into the accounts payable system
- some employees had excessive user privileges
- some employees had unnecessary access to the accounts payable system.

All agencies surveyed included accounts payable within the scope of internal audit examination. This occurred at least once every 3 years, or more frequently. Issues raised by internal audits have generally been minor. In some instances, external consultants have been engaged to conduct compliance reviews of control frameworks.

Several agencies also conducted compliance reviews using finance and administration staff.

### Conclusions

Although procedures to authorise, certify and pay for procurements are adequate, some (generally minor) problems persist in authorising and certifying expenditure.

Delegations to authorise expenditure need to have limits. The absence of prescribed limits (either individually or collectively) negates the purpose of delegated authority and exposes agencies to increased risk of inappropriate expenditure.

Failure to detect breaches of delegation limits also negates the value of limits as means of controlling expenditure. Restrictions on delegations are only effective as a control when they are monitored and enforced.

The number of purchase orders that were raised after the expenditure had been incurred weakened agencies' commitment control. The weakness resulted in insufficient information about current commitments, exposing agencies to the risk of overspending budgets. Methods to reduce the raising of commitments after the expenditure has been incurred include the use of standing orders and improved training.

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[6] These normally include name, address, phone numbers, terms of trade, ABN number, payment method and bank account details (if applicable).

The certification of invoices for items that have already been paid for (that is, duplicate payments) is a concern.

All agencies segregated duties between those who authorised expenditures (raised purchase orders) and made payments.

## Recommendations

**29.** **That all agencies set upper limits to expenditure delegations; and that these limits be built into the accounts payable IT systems, so they cannot be exceeded.**

**30.** **That all agencies have and enforce procedures to improve the management of commitments and raising of purchase orders.**

**31.** **That all agencies train staff to detect and avoid duplicate payments.**

**32.** **That all agencies periodically investigate whether duplicate payments have been made, and use the results of investigations to improve and enforce procedures to prevent duplicate payments.**

### RESPONSE provided by Secretary, Department of Treasury and Finance

*DTF notes recommendation 29. Presently, all delegations held by DTF officers have an upper limit. The department's electronic procurement system does have delegation limits loaded and are essential for the workflow aspects of the application.*

*DTF also notes recommendations 30 to 32 but points out that with the introduction of electronic procurement front ends to accounts payable systems, purchase orders are now generally held in the procurement application.*

### RESPONSE provided by Secretary, Department of Sustainability and Environment

*Recommendations 29 to 32 agreed. The internet procurement tool utilised by the DSE already has provision to set dollar limits according to the delegations approved the CFO. DSE's procurement policies and procedures are fully documented and available to all staff on the intranet. This includes the requirement to raise a purchase order prior to the incurring of expenditure.*

*DSE, through its shared services provider, provides training and advice on the use of the procurement tools used by the department. Such training and advice includes details of measures users of the procurement tools should take to minimise the risk of duplicate payments being made. In addition, DSE, through its shared services provider, receives a suite of reports that are configured and used to identify transactions that require further investigation in order to determine whether or not the supplier has been paid more than once for the same supply.*

### RESPONSE provided by Chief Commissioner of Police

*In relation to recommendations 29 to 32, Victoria Police acknowledges the findings in the report. This agency has implemented a comprehensive financial management compliance regime by introducing electronic financial delegations, an electronic accounting manual (via the intranet) and undertaking compliance audit across the organisation. The issue of duplicate payment is being addressed by examining appropriate detection software for this purpose and staff receiving further training.*

### RESPONSE provided by Managing Director, City West Water Limited

*Upper limits are stated in City West Water's delegation of authority and are built into our finance system.*

*City West Water purchasing procedure requires expenditure on goods/services to be approved prior to it being incurred. However, some aspects of the procurement process are specifically exempted from the procedures eg: the purchase of goods and services in emergency/urgent situations. In these cases, the procedure specifically allows for the purchase order to be raised after the expenditure has been incurred. The purchasing procedure also stipulates that contract and regular payments such utility costs are excluded from the purchase order procedure.*

*However, in relation to the some of our IT expenditure, our suppliers require that we provide a purchase order even though the invoice may have been issued and the expenditure has been approved at CWW.*

*It should be noted that due to the fact that the majority of CWW's payments are made through the contract payment process, the tracking of commitment is made through the contract schedule process rather than the purchase order system. Nonetheless, CWW will adopt the following stepped approach to further address this issue:*

- *the requirement to raise purchase orders prior to incurring expenditure will be reinforced with all staff. This includes the increased use of standing orders*

- *invoices, requiring a purchase order, will be monitored and those without orders raised will be highlighted at supervisor/manager level with the respective requisition authorising officer*

- *suppliers who repeatedly supply goods/services to CWW without quoting a relevant purchase order will be contacted to remind them of our requirements.*

*City West Water believes that it has adequate internal procedures and system controls in place to limit the number of duplicate payments. Staff who review and approve payments have been appropriately trained.*

*In relation to recommendation 32, City West Water will undertake this review as part of its periodic review of accounts payable.*

## Were agency accounts payable systems efficient, and were suppliers' terms met?

The accounts payable process is a significant cost to agencies, and the technology behind it is constantly changing. Online purchasing, system-based matching of documentation to authorisations, electronic funds transfer and the use of email to raise orders and send remittance advice are all relatively new technologies. They have both risks and opportunities for efficiency gains.

In assessing whether agency accounts payable processes were efficient, and they met suppliers' terms, we examined if:

- purchase orders were raised and approved online
- goods received were matched to orders online
- electronic funds transfer was the preferred method of payment
- email was used to communicate purchase orders and remittance advice with suppliers
- supplier terms were met.

Agencies that use electronic purchasing and payment systems can raise and approve purchase orders online. Agencies that do not use such systems use purchase order books to raise purchase orders, which are approved manually. Manual purchase order systems need extensive controls to ensure accountability and the safeguarding of documents. The checking needed to avoid breaches of delegation limits when manual purchase orders are used is significantly more cumbersome than with online systems.

Agencies that were reviewed, and that had electronic purchasing systems, benefited to varying degrees from online purchasing, and from the automation of some aspects of the certification process.

Online purchase order systems are impractical in some situations (particularly when orders must be approved outside the office), but we found few of these situations.

Most agencies surveyed and reviewed checked goods received manually. The length of time required by an agency to do this, and to certify purchases, often resulted in suppliers' terms not being met. It also increased the risk of duplicate payments when reminder invoices were received.

Agencies reviewed accepted a range of supplier terms, from immediate to 30 days payment. The Minister for Finance requires agencies operating under the Financial Management Act to have in place a system to pay all debts as and when they fall due and payable.

Figure 2.2C shows the rate of compliance with the most common agreed supplier terms by the agencies reviewed[7]. The figure details the rate at which agencies meet the more common supplier terms. Although some failures resulted from contested invoices and supplier delays, most resulted from delays in agency certification processes. The figure shows that compliance rates improved as the supplier terms increased towards 30 days.

**FIGURE 2.2C: RATE OF COMPLIANCE WITH SUPPLIER TERMS (BY TRANSACTION)**

| Agency | 7 days | 14 days | 30 days |
|---|---|---|---|
| Department of Treasury and Finance | 55.7% | 47.6% | 75.3% |
| Victoria Police | 35.0% | 42.1% | 72.3% |
| Department of Sustainability and Environment | 64.9% | 75.5% | 93.3% |
| Department of Primary Industries | 61.3% | 74.2% | 90.0% |
| City West Water (a) | 96.6% | 81.9% | 72.2% |

(a) The payment terms for City West Water refer to the number of days from the end of the month in which an invoice is received.

One point to note about the preceding figure is that in some agencies the supplier terms detailed in the accounts payable system were less than those required by the supplier. These shorter terms had been set by management to avoid the complications that arise when supplier terms are not met. In particular, significant costs can be incurred in checking reminder invoices, reconciling creditor information and handling supplier inquiries. By reducing the time to pay the accounts, management has reduced the risk that failure to meet the supplier terms will lead to the additional complications detailed above.

The most common supplier terms for the agencies reviewed was 30 days from the date of issue of an invoice. Most agencies also considered these the default terms if the supplier did not specify terms. For all transactions by the 6 agencies between 1 July 2003 and 29 February 2004, Figure 2.2D shows the number of transactions that were subject (or considered subject) to 30 day terms, and the lateness of payments. It shows that 77 per cent of all these transactions were paid within 30 days, and another 18 per cent within 60 days.

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[7] Except for the Greater Shepparton City Council, for which information was not available.

**FIGURE 2.2D: EXTENT OF LATE PAYMENTS WHEN SUPPLIER TERMS WERE 30 DAYS**

| Agency | Met terms | Days late | | | |
|---|---|---|---|---|---|
| | | 1-30 | 31-60 | 61-90 | >90 |
| Department of Treasury and Finance | 6 988 | 1 635 | 351 | 149 | 155 |
| Victoria Police | 53 666 | 16 228 | 2 759 | 878 | 722 |
| Department of Sustainability and Environment | 15 345 | 1 449 | 4 | 1 | - |
| Department of Primary Industries | 13 144 | 1 450 | 15 | - | - |
| City West Water | 17 816 | 5 112 | 820 | 364 | 551 |
| **Total transactions** | **106 959** | **25 874** | **3 949** | **1 392** | **1 428** |
| **Percentage of total transactions** | **77%** | **18%** | **3%** | **1%** | **1%** |

All agencies reviewed paid suppliers either by cheque or electronically. Payments to suppliers were most commonly made weekly. While several agencies preferred to make payments electronically (and encouraged suppliers to use this method), most made payments in the way preferred by suppliers. Figure 2.2E shows the methods used by surveyed agencies, and that almost 60 per cent are using electronic methods.

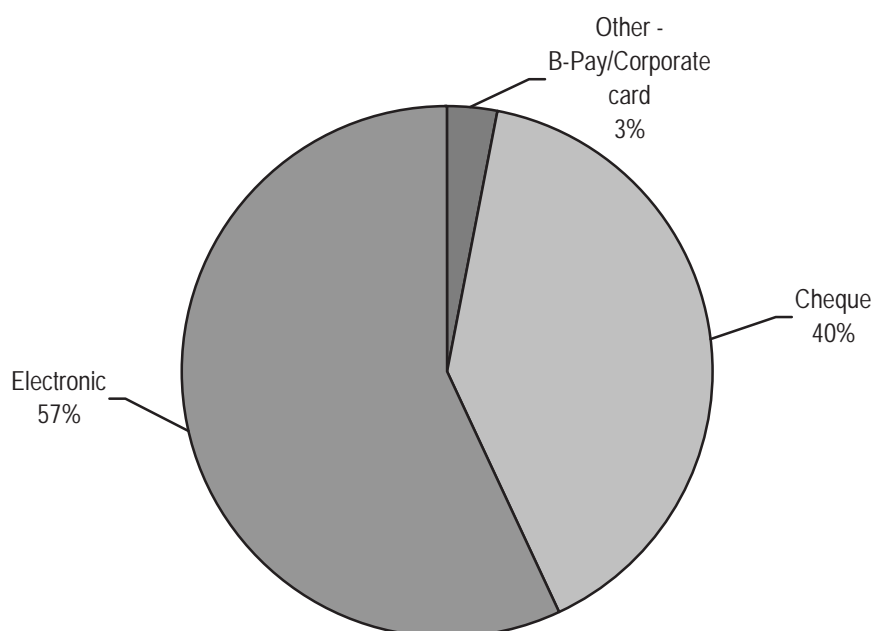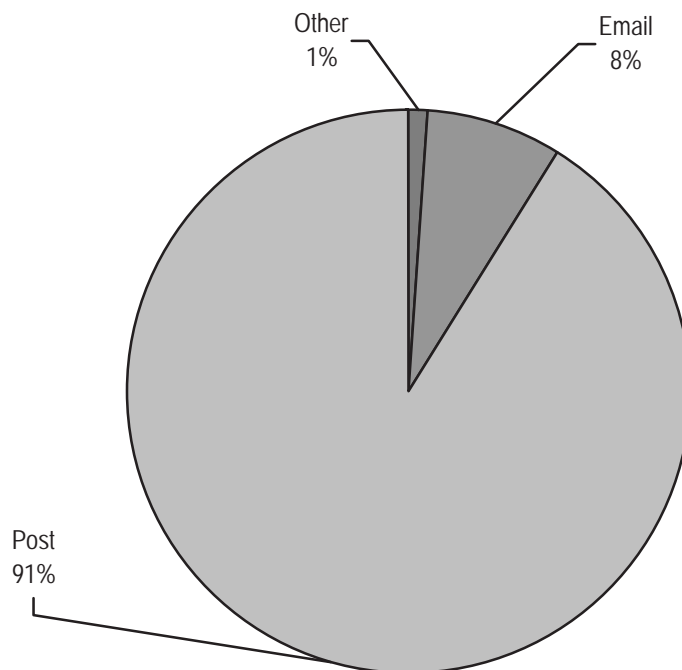**FIGURE 2.2E: METHOD OF PAYING ACCOUNTS AT AGENCIES SURVEYED**

Figure 2.2F shows how agencies surveyed send remittance advice to suppliers. In 2002-03, the 18 agencies surveyed sent over 750 000 remittance advice notices through the post to suppliers.

**FIGURES 2.2F: METHOD OF SENDING REMITTANCE ADVICE AT AGENCIES SURVEYED**



## *Conclusions*

Although there is room for further improvement, surveyed agencies have adopted new technologies that will make the processing of accounts payable more efficient. These technologies save money by reducing the number of cheques that must be generated and mailed, and enable better control and simplified accounting procedures to be adopted.

All agencies reviewed were finding it difficult to meet supplier terms and government policy (which is to either meet supplier terms or pay accounts within 30 days of receiving an invoice). This, in turn, is likely to be creating difficulties for suppliers.

Given that agencies reviewed are meeting supplier terms in only 77 per cent of the transactions, it is also likely to be the case across the wider public sector.

Although almost 60 per cent of agencies surveyed are paying accounts by electronic funds transfer, they are not receiving the full benefits from the adoption of new technology because almost all agencies still send remittance advices notices to suppliers through the post. The extensive use of traditional mail to deliver remittance advice notices means that even a moderate move from post to email could lead to significant cost savings.

## Recommendations

**33.** **That all agencies that are not utilising recent developments in purchasing, including online purchase processing, electronic funds transfer and email should consider such enhancements. Agencies must ensure that such systems have adequate controls over supplier data and the creation of new suppliers.**

**34.** **Agencies should ensure that processes are incorporated into their accounts payable function to enable suppliers' terms to be met. This process should include a review of performance and investigation of areas where terms are not being meet.**

**35.** **Agencies should investigate options for advising clients of payments through electronic means.**

### RESPONSE provided by Secretary, Department of Treasury and Finance

*DTF notes the above recommendations and has implemented a number of initiatives around electronic systems, including procurement, to maximise these benefits. DTF also notes the comment in the report that in some agencies the supplier terms detailed in the accounts payable system were less than those required by the supplier. Consequently, where this occurs, as in the case in DTF, the interpretations of the results can be erroneous.*

### RESPONSE provided by Secretary, Department of Sustainability and Environment

*Recommendation 33 agreed. DSE's procurement tools already utilise online purchasing, electronic funds transfer and email notification to suppliers of payments. Those suppliers still receiving cheque payments are provided a form on the back of the remittance advice to complete if they wish to move to EFT payments. Integrity over supplier data is maintained and controlled centrally by DSE's shared services provider.*

*Recommendation 34 partially agreed. DSE does not believe that supplier's terms should be taken as the default. The default terms used by DSE is 30 days from the date of the supplier's invoice or the date the goods were received, whichever is earlier (subject to the goods having been received). The system has recently been reconfigured to pay on these terms. This enhancement will increase the already high rate of compliance with payments to suppliers within agreed terms.*

*RESPONSE provided by Secretary, Department of Sustainability and Environment - continued*

*Reports are available that can be configured to identify transactions that require further investigation in order to determine whether or not the department has paid suppliers according to agreed terms. It is proposed to make greater use of these reports in the future.*

*Recommendation 35 agreed. The procurement tools used by DSE already provide that those suppliers being paid by electronic funds transfer receive their remittance advice by email. Suppliers receiving payments electronically do not receive hardcopy remittance advices.*

*RESPONSE provided by Chief Commissioner of Police*

*Victoria Police acknowledges the findings of the Auditor-General in respect of this issue. This agency continually reviews the performance of supplier payments and makes every effort to meet supplier terms. There has been a concerted effort to convert suppliers to accept electronic payments, which will assist this agency in meeting their payment terms.*

*RESPONSE provided by Managing Director, City West Water Limited*

*City West Water is utilising these developments in areas such as purchase order raising and approval and in ordering stationery etc. (recommendation 33).*

*The late payments that fall into the categories 61-90 and >90 would generally relate to developer contribution refunds. With these payments, the costing information is recorded in the accounts payable system and put on hold and the payment is not usually made to the supplier until after the expiration of the maintenance period. In some instances, the delay is also caused by the late receipt of a valid tax invoice or the resolution of a dispute before the payment is released.*

*City West Water has promoted the use of EFT in verbal contact with suppliers and through the use of notes with their cheque payments. The form used to request a new supplier is also a prompt for the requisitioner to enquire about EFT details.*

## Did agencies adequately control supplier details?

A significant control over the accounts payable process (and also a source of efficiency) is to minimise the number of suppliers for each particular type of goods and services.

The supplier master file in an accounts payable systems contains all supplier details. It is a key file that needs very tight controls. Controls need to address who is authorised to enter new supplier details and amend existing supplier details. All changes should be approved by another person, and all changes regularly reviewed to ensure they are bona fide.

These controls are even more important if the agency transfers funds electronically. Loose controls over who knows, and can amend, supplier bank account details increase the risk of unauthorised changes leading to fraud.

In assessing whether agency accounts payable procedures ensured that suppliers' details were adequately controlled, we examined if:

- new suppliers' records were created after an adequate assessment and authorisation process
- preferred supplier agreements were considered when selecting an appropriate supplier
- purchasing and payables functions (that is, creating new suppliers, amending existing details and processing payments) were adequately segregated
- access to suppliers' details was adequately restricted
- reports of master file changes were generated and reviewed at least monthly
- reports of suppliers not used in the past 12 months were generated and reviewed at least quarterly
- other exception reports were generated regularly, and covered matters such as duplicate suppliers, suppliers with no address and duplicate ABN numbers.

Agencies surveyed and reviewed exercised only limited controls over the number of suppliers.

Figure 2.2G shows the number of active suppliers to the 6 agencies reviewed in detail.

**FIGURE 2.2G: NUMBER OF ACTIVE SUPPLIERS TO SELECTED AGENCIES**

| Agency | Active suppliers (a) |
|---|---|
| Department of Treasury and Finance | 19 071 |
| Victoria Police | 6 296 |
| Department of Sustainability and Environment | 7 622 |
| Department of Primary Industries | 11 557 |
| City West Water | 1 113 |
| Greater Shepparton City Council | 732 |

(a)  A number of agencies include as suppliers a range of grant and refund recipients. These are not readily distinguishable from other suppliers.

The agencies in Figure 2.2G conducted some checks before approving new suppliers, but these did not include investigating whether the agency had a purchasing agreement for the goods or services. Within the agencies, awareness of purchasing agreements was limited. While awareness of major contracts (such as for fuel purchasing) was high, little consideration had been given to the potential benefits of these agreements for a broader range of purchases.

An indicator of the level of control over supplier details and the addition of new suppliers is the level of duplicate suppliers within the accounts payable system. Australian business numbers (ABNs) provide a unique identifier for each supplier. The existence of duplicate ABNs is a strong indicator of a supplier being duplicated. Figure 2.2H shows the number of suppliers with duplicate ABNs in the systems of the 6 agencies reviewed in detail.

**FIGURE 2.2H: NUMBER OF DUPLICATE ABNS IN SELECTED AGENCY SYSTEMS**

| Agency | Duplicate ABN |
|---|---|
| Department of Treasury and Finance | - |
| Victoria Police | 45 |
| Department of Sustainability and Environment | 561 |
| Department of Primary Industries | 527 |
| City West Water | 31 |
| Greater Shepparton City Council | 15 |

In all agencies reviewed, the creation and amendment of supplier master files was adequately segregated from the processing of invoices for payment. The authority to process master file changes was generally restricted to 2 or 3 appropriate staff within an agency. These staff amend master files on the basis of information provided by suppliers or other staff.

Most agencies generated reports recording master file changes, but reviews of these reports were not clearly documented. As such, a risk exists that inappropriate changes to master files may not be detected or that changes may be made on the basis of inappropriate documentation. Several agencies only conducted minimal reviews of master file changes.

None of the agencies reviewed reports that identified suppliers that had not been used in the last 12 months. Neither did they have formal processes for removing suppliers from their master files, nor produce other reports to ensure the integrity of the supplier master file.

## *Conclusions*

Agencies have established internal controls over supplier details. Most agencies have strong segregation and access controls.

Agencies were not adequately monitoring and seeking processing efficiency by minimising the number of suppliers they used. The high numbers of suppliers to some agencies indicates that controls over the addition of suppliers to the accounts payable system were inadequate. In many agencies, it was easy to add new suppliers to the master file, and agencies did not adequately review the list of suppliers and delete duplicate and inactive suppliers.

# Recommendations

**36.** **That all agencies review their processes to add new suppliers to the accounts payable system. In particular, they should adequately check that an existing supplier is not already available, and that the proposed supplier is not already on the system.**

**37.** **That all agencies consider existing cross-government purchasing agreements, as part of selecting new suppliers.**

**38.** **That all agencies:**

- **generate reports of master file changes at least monthly**
- **have an independent officer verify that all changes and additions to the master file are legitimate**
- **retain all reports and verification documentation.**

**39.** **That all agencies periodically generate reports of suppliers not used in the past 12 months; such suppliers should be deactivated and details only retained where necessary (such as for future FOI requirements).**

**40.** **That all agencies generate exception reports (that identify duplicate suppliers and incomplete details), to assure the integrity of their data.**

### RESPONSE provided by Secretary, Department of Treasury and Finance

*DTF notes recommendation 36 and the footnote in figure 2.2G, which indicates that although the Auditor-General's office has identified some vendors as suppliers, they are in fact, grant and refund recipients. DTF also notes the remaining above recommendations and confirms that recommendation 38 is part of the internal audit review conducted annually and, in regard to recommendation 39, that records must be retained for FOI purposes.*

### RESPONSE provided by Secretary, Department of Sustainability and Environment

*Recommendations 36, 37, 39 and 40 agreed. DSE's shared services provider has processes in place to ensure that additions to the vendor master file are only made once the supplier has been determined not to already exist. Where available, DSE uses whole of government (WofG) or departmental standing offer contracts for the supply of goods or services. Where available and applicable, DSE also participates in open standing offer agreements (OSOA) established by other departments. Further, Procurement (DTF) consults regularly with departments seeking opportunities to improve procurement through the establishment of further WofG contracts.*

*DSE will liaise with is shared services provider to identify those suppliers who have not been used in the past 12 months on an annual basis and nominate those deemed appropriate for deactivation.*

*RESPONSE provided by Secretary, Department of Sustainability and Environment - continued*

*Recommendation 38 not agreed. While DSE's shared services provider will be able to generate such a report for the review, this seems an unnecessary duplication of the service already provided by the shared services provider as outlined in recommendation 16.*

*RESPONSE provided by Chief Commissioner of Police*

*Victoria Police acknowledges the recommendations in the Auditor-General's report in respect of this issue.*

*RESPONSE provided by Managing Director, City West Water Limited*

*City West Water has recently introduced a monthly review of amendments to the supplier master file and a quarterly review of its supplier records. The review primarily focuses on duplicate suppliers/ABNs. Any suppliers that are no longer current are coded as "inactive" but not deleted so that any history relating to that particular supplier is maintained. An ongoing review will occur on inactive suppliers.*

## Was oversight and performance management of accounts payable functions adequate?

An agency's accounts payable function includes its policies, procedures, work processes, information technology (or manual) systems and controls.

Internal controls over the function should include supervision by managers, comparison of financial reports with budgets, performance management and internal audits.

In assessing whether oversight and performance management of accounts payable functions was adequate, we examined if:

- the accounts payable function was internally audited at least every 3 years
- staff access (and their level of access) to the accounts payable system was reviewed at least quarterly
- the creditors balance was reconciled to the general ledger monthly, and if the reconciliation was independently and promptly reviewed
- the age profile of creditors was regularly monitored to minimise late payment
- a register of supplier complaints about late payment was maintained and reviewed
- performance targets for the accounts payable function were set and monitored.

Agencies internally audit their accounts payable functions with varying frequencies. Some agencies conduct these internal audits annually. Other agencies conduct cyclical audits. Issues raised by internal audit in the past 12 months were generally minor, and no major weaknesses were found.

Some agencies have engaged external consultants to conduct compliance reviews of their accounts payable functions, to provide the agency with additional assurance about their integrity.

Agencies examined do not regularly review staff access, and levels of staff access, to the accounts payable system. These agencies controlled the initial approval of a user, and controlled subsequent changes to their level of access. Although this provided some level of assurance, the lack of periodic reviews increased the risk of unnecessary access.

All agencies reviewed reconciled the creditors balance from the accounts payable system to the general ledger each month, and independently reviewed the reconciliation.

Agencies reviewed generated various financial and management reports. These included budget to actual, encumbrances, number of transactions and batch control details. Information from the reports was consolidated into monthly management reports and presented to management for review.

The age profile of creditors was not formally monitored by any of the agencies. However, it was indirectly reviewed through the monthly creditors reconciliation. Most agencies produced and reviewed an aged creditors report, highlighting supplier balances due for payment.

Agencies reviewed relied on supplier complaints to alert them to unpaid invoices. Agencies did not maintain registers of supplier complaints. As a result, they had no formal method to identify recurring issues or problems with unpaid invoices.

None of the agencies surveyed had benchmarks against which to monitor the performance of their accounts payable system.

### Conclusions

Agency oversight of their accounts payable systems was adequate.

While there is evidence that managers monitored the performance of their accounts payable systems, monitoring of access to systems could be improved.

Agencies also need to establish performance indicators, and ways to measure performance, for their accounts payable systems.

## Recommendations

**41.    That all agencies regularly and independently review staff access, and levels of access, to their accounts payable systems.**

**42.    That agencies develop performance indicators against which their accounts payable functions can be assessed. Such indicators could include benchmarks for methods of payment and remittance, the ageing of creditors, the number of late payments, supplier complaints, the number of active suppliers and average processing cost.**

### RESPONSE provided by Secretary, Department of Treasury and Finance

*DTF notes these recommendations.*

### RESPONSE provided by Secretary, Department of Sustainability and Environment

*Recommendations partially agreed. The procurement tools used by DSE are such that all staff need system access to create requisitions, however, only delegated officers may approve such requisitions and commit the department to the expenditure. The level of access to the core accounts payable application to update vendor records, process adjustment notes, and trigger cheque and EFT payments is limited to DSE's shared services provider staff and key DSE finance staff.*

*In relation to recommendation 42, DSE believes that such benchmarking should be limited to other public sector agencies, and not commercial entities whose economies of scale and scope can vary dramatically and could produce distorted and unachievable benchmarks. Further, we would not advocate benchmarking supplier complaints as this could be dictated by the service that the particular agency provides. The number of active suppliers and average processing cost are also indicators which would provide little value being benchmarked given the difference in size and processing methods of the agencies. All other indicators proposed are deemed reasonable for comparison across public sector entities.*

### RESPONSE provided by Chief Commissioner of Police

*Victoria Police acknowledges the recommendations in the Auditor-General's report in respect of these issues.*

### RESPONSE provided by Managing Director, City West Water Limited

*CWW has performed an overall review of access across all users of its finance system and will continue to do so periodically. City West Water will consider the implementation of performance indicators for its accounts payable function.*

### RESPONSE provided by Chairman, Victorian Government Purchasing Board

*General comments*

*The Board's comments on the recommendations are restricted to recommendations 21-28 as these relate to the Board policies and functions. In general, the Board welcomes the intent of the recommendations and the explicit endorsement and support they provide to our current activities. A number of the recommendations have both resource and legislative consequences and it will require consultation among the Board, the department and the minister to determine whether, when and how to act upon the proposals.*

### RESPONSE provided by Acting Secretary, Department of Primary Industries

*General comment*

*The Department of Primary Industries accepts the recommendations raised in this report and will continue to comply with the procurement policies of the Victorian Government Purchasing Board and the Financial Management Act 1994.*

### RESPONSE provided by Chief Executive, Greater Shepparton City Council

*We recognise the report as a comprehensive response and agree with the recommendations made.*

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# 3.  Performance audits

♦ ♦ ♦ ♦ ♦ ♦ ♦ ♦ ♦ ♦ ♦ ♦ ♦

# 3.1    Development of policy advice

## 3.1.1 Audit conclusion

Providing robust advice to enable government to make informed decisions on public policy issues is one of the most important responsibilities of the public sector.

This audit considered the ways that government departments developed well-researched, comprehensive policy advice briefs for government. As such, it considered only one aspect of the policy advice work that departments undertake. It did not consider the decision-making process by government, the merits of policy advice or the implementation of this advice.

The 8 policy development projects examined showed sound processes around the core "subject matter" issues at stake – defining the issue, scope and objectives of the policy advice; and systematically reviewing evidence and available options.

Consultation during policy development was variable. Staff on the projects examined were generally skilled and experienced at liaising with government and other internal stakeholders, however, processes for engaging with external stakeholders need to be made more systematic and rigorous. All projects were committed to stakeholder consultation, but some would benefit from better front-end planning to ensure that relevant stakeholders are systematically identified, and appropriate ways of consulting are identified.

The need for improved planning for consultation links to a related weakness in some of the policy development projects examined – the need to apply disciplined project management methodologies. This includes better planning for project risk management, budget management and provision for project evaluation.

While all projects examined considered the risks associated with options and recommendations when advice was being developed, not all made explicit statements of risk when the minister was briefed. In some cases, risks were identified but not mitigation strategies. Failure to provide clear statements of any risks associated with recommendations can mean that either the minister is not informed, or that the departmental team makes only risk averse recommendations.

The 3 departments examined were conscious of the need to develop and maintain the core capabilities of policy advice and recognised these responsibilities in their core departmental planning. All were facing challenges of developing and maintaining staff skills in this area. It takes time and experience to build policy skills, and departments were addressing these needs in their work force and staff development planning.

## 3.1.2 About the development of policy advice

### What is "policy"?

Policy "… is the process by which governments translate their political vision into programs and actions to deliver 'outcomes' – desired changes in the real world"[8]. A major part of government interaction with the community is around the development, implementation, review and modification of policy.

The term "policy" can have many meanings, ranging from high-level and broad directions statements established through the political process by government, down to specific administrative decisions that are taken by divisions within government departments. All of the following examples are "policy":

- major statements of direction or whole of government priority statements, e.g. *Growing Victoria Together*
- wide-ranging and multiple recommendations in a cohesive strategy to address complex sets of social or economic problems, e.g. Victoria's *Arrive alive - Road safety strategy*
- actions, programs or legislation to address specific and defined problems, e.g. amendments to the law to enable the confiscation of assets of certain kinds of offenders
- review of programs or legislation and development/implementation of recommendations for change
- a direction on administrative or procedural matters, operating standards or business rules.

In any jurisdiction, each part of this policy hierarchy supports and shapes the others. Good policy is never developed in isolation. It is developed in the context of horizontal links to related policies, practices and legislation in other agencies, and vertical links to government's higher level policy or directions statements. Together, these form what is sometimes described as a "policy framework".

### What is "policy development"?

Managing policy is often pictured as a cycle, in which issues or problems are identified, possible ways of addressing the issue are considered, consultation on options occurs, a decision is made to implement change, changes are implemented, the outcomes are evaluated, and further changes, refinements or adjustments may be developed. This process is never simple or linear, and often multiple steps on the cycle occur simultaneously.

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[8] United Kingdom Cabinet Office, 1999, *Professional policy making for the twenty first century*.

*Policy development* includes a number of stages in this larger policy management cycle, as shown in Figure 3.1A.

**FIGURE 3.1A: POLICY DEVELOPMENT AND THE POLICY CYCLE**
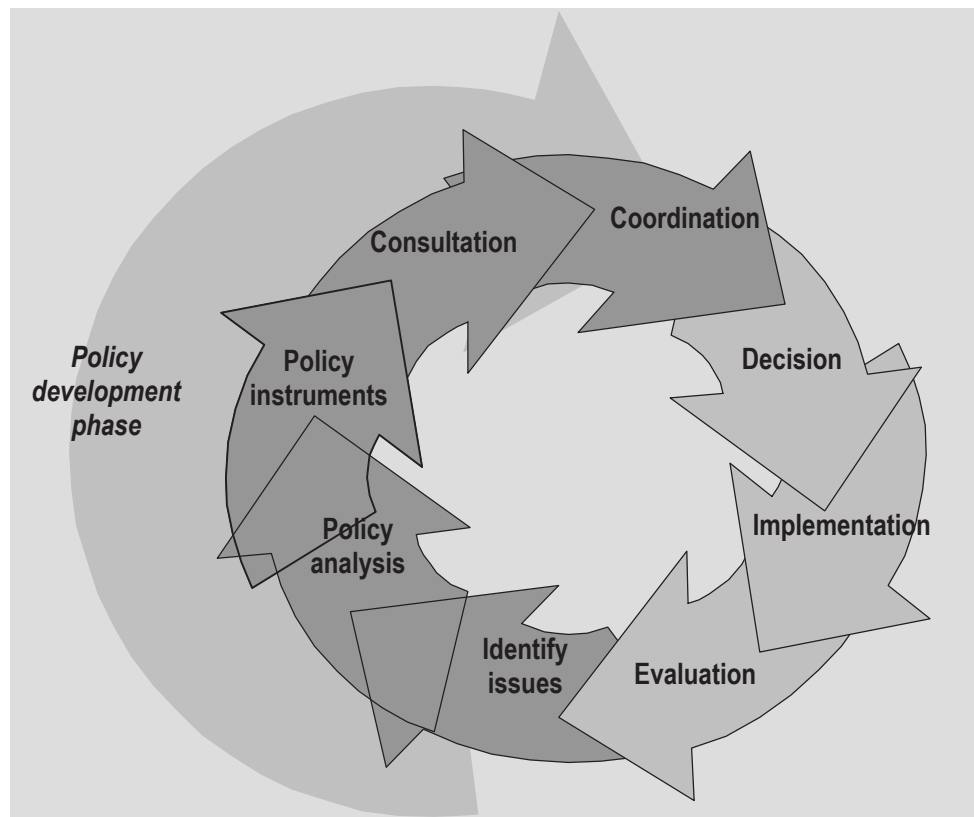


*Source:* Victorian Auditor-General's Office, adapted from Bridgeman and Davis[9].

## The public sector's role and responsibilities in developing policy advice

Government departments provide ministers and Cabinet with policy advice to help them evaluate the merits of alternative courses of action. Public policy issues are often complex, involve many stakeholders and cut across different areas of government operations. Processes to develop policy advice need to take account of these complexities, and ensure that advice is based on the best available information. Recommended actions must also be feasible in environmental, social, economic and administrative terms.

It is the public sector's responsibility to ensure that advice provided to government is unbiased and independent. A good process does not guarantee that sound policy will be developed, but poor processes increase the risk of unsatisfactory policy development. Policy development processes need to be robust and defensible.

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[9] P Bridgman and G Davis, *The Australian Policy Handbook*, 2nd Ed, Allen and Unwin, Sydney, 2000.

Although policy advice to government may come from many sources, the primary sources of advice and supporting policy development in Victoria are the government departments. There are 10 departments in Victoria; 8 receive budget appropriations for the provision of policy advice, and policy advice delivery targets are specified in the state budget papers.

As well as providing policy advice in their portfolio areas, the Department of Treasury and Finance and Department of Premier and Cabinet, play an important quality assurance and coordination role. Policy proposals developed by other agencies are reviewed by these 2 central agencies to ensure that the wider social, economic and financial impacts have been fully considered. This guards against advice being given to government based solely on a single department's perspective on the issue.

## 3.1.3 Conduct of the audit

### Scope of the audit

This audit considered the key features of policy development – how government departments define issues, investigate options for action, and make recommendations to the minister and government. It considered whether selected departments have the key features of good policy development processes in place.

The audit did not consider the merits of a particular policy position. Nor did it consider other parts of the policy management cycle such as the decision-making process used by government when policy options have been recommended, the implementation of the recommendations made in policy briefs or the achievement of outcomes of policy projects.

A conceptual framework for the policy development process is shown in Figure 3.1B. There are many others.

**FIGURE 3.1B: A POLICY DEVELOPMENT MODEL**
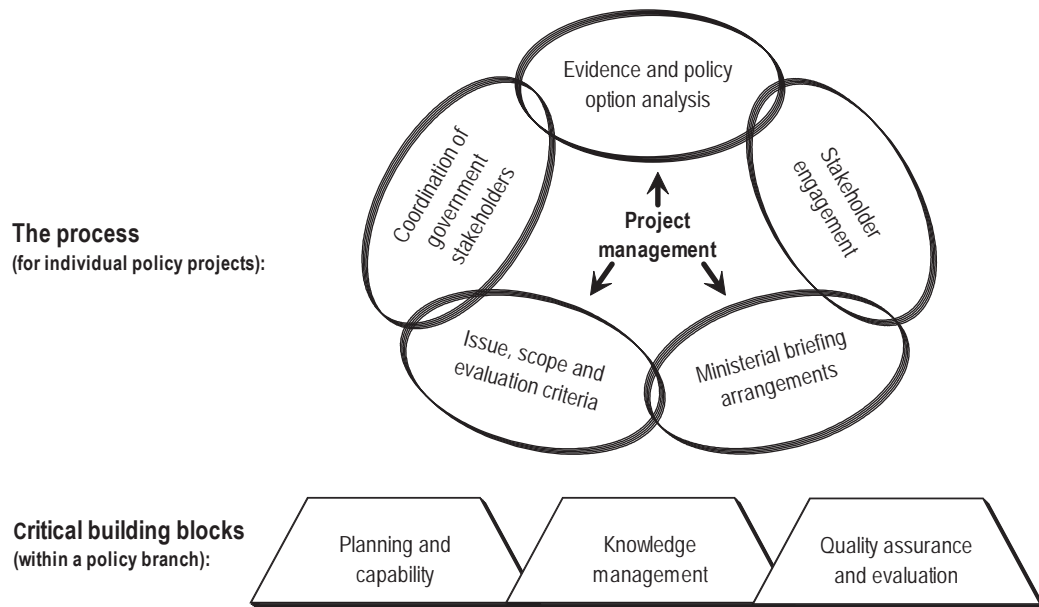


*Source:* Victorian Auditor-General's Office.

This model illustrates 2 aspects of the development of policy advice that we considered in this audit:

- The process of developing advice on an individual issue or single policy project – these are the project-specific steps that will be taken in any single policy project of a reasonable size. As Figure 3.1B shows, the stages in this process overlap and impact on one another.

- The second part of the model considers the critical building blocks or capabilities within a policy division. These are the aspects that need to be managed by a department and within a policy development unit in order to ensure that they develop and maintain their capacity to provide high-quality policy advice.

For the purposes of the audit we used the following definitions:

- "policy" is a decision resulting from consideration by a minister or government

- "policy advice" is the documented information provided to the minister or government to enable a decision to be made

- "policy development processes" are processes employed to develop the "policy advice" submitted to the minister or government.

## Audit methodology

The elements of "good practice" in policy management were determined through a comprehensive literature search and interviews with experts. Reference was also made to audits and reviews of policy development conducted elsewhere, including reviews by the United Kingdom Cabinet Office[10]; the Office of Auditor-General in Manitoba, Canada[11]; the State Service Commission in New Zealand[12, 13]; and the Australian National Audit Office[14].

Audit field work was undertaken in policy divisions within the Department of Justice, the Department of Infrastructure and the Department of Treasury and Finance. These divisions or branches only represented one policy development unit in each department. Many other areas in each department provide policy advice.

Within these departments, 8 specific policy briefs were selected for examination in detail. The projects examined in depth varied significantly in their size, objectives, scope and methods used. The audit took into account the extent to which the elements of effective policy development were fit for purpose.

While the audit findings in the early part of this article apply only to these briefs, the recommendations and general principles have wider application.

We also considered the way the 3 departments examined, developed and maintained their capacity to provide sound policy advice. We considered key planning documents and the systems in place to develop and maintain the departments' core capabilities of policy advice development.

The audit was performed in accordance with Australian Auditing Standards applicable to performance audits.

Specialist advice was provided by Professor John Wiseman of Victoria University and Dr Russell Ayres of MRA Consulting Pty Ltd.

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[10] United Kingdom Cabinet Office, 1999, *Professional policy making for the twenty first century*.

[11] Office of the Auditor-General, Manitoba, 2003, *A guide to policy development*.

[12] State Services Commission of New Zealand, 1999, Occasional Paper Number 9, *Essential ingredients – improving the quality of policy advice*.

[13] State Services Commission of New Zealand, 1999, Occasional Paper Number 22, *High Fliers: Developing high performing policy units*.

[14] Australian National Audit Office, 2001, Performance audit, *Developing Policy Advice*.

## 3.1.4 Policy development processes

This part of the article comments on the process that government departments adopt to develop policy advice in response to a specific issue.

We examined 8 specific cases where policy briefs were developed. These briefs were all moderately large policy development tasks, where an issue was investigated over a period of time, options were considered and tested, and formal recommendations were made to government.

In some cases, a considerable amount of initial investigation work had been undertaken, and the project was extended to also cover the development of programs and/or legislation that would put into effect the recommendations of an earlier investigation. In other cases, all that was clear at the start of the project was that government wanted to take further action on a particular issue, and the objective of the project was to investigate and recommend options.

In the cases we examined, the process of policy development is analogous to any other public sector project. The project output in this case is the provision of a detailed and well-informed advice brief to the minister or government. This brief should identify feasible options; the social, economic, administrative and legislative implications of each option; and advantages, disadvantages and risks.

The 8 projects considered illustrate a wide range of policy development activities.

### Policy briefs examined

| Department | Policy brief |
|---|---|
| Department of Justice | **Drugs Poisons and Controlled Substances (Volatile Substances) Act 2003**<br><br>This project involved the development of the legal framework to give effect to the government's response to the Victorian Parliamentary Drugs and Crime Prevention Committee's Final Report *Inquiry into the inhalation of volatile substances*.<br><br>The project developed Cabinet submissions, drafting instructions and legislation, and the development of a mobile service delivery model. |
| Department of Justice | **Confiscation (Amendment) Bill 2003**<br><br>This project saw the preparation of amendments to legislation for asset confiscation of offenders.<br><br>It made major amendments to 2 areas of asset confiscation law and practice:<br><br>• changes to management of seized, restrained and forfeited property<br>• changes to allow better information gathering for confiscation proceedings. |
| Department of Justice | **Guardianship and Administration Act 1986 - amendments**<br><br>This project addressed problems in the application of the *Guardianship and Administration Act 1986*. It involved developing amendments to legislation, supported by an education campaign advising of the amendments. |
| Department of Treasury and Finance | **Environmental reporting framework**<br><br>This project involved the development of an environmental reporting framework for government departments. The policy development project output was a joint submission to government from the Minister for Finance and the Minister for Environment and Conservation recommending options for implementing this framework in government departments. |

## Policy briefs examined - continued

| Department | Policy brief |
|---|---|
| Department of Treasury and Finance | **Environmental taxes and charges**<br><br>This project provided the Treasurer with advice on the role that environmental taxes and charges can play in managing natural resources.<br><br>The advice was based on internal research undertaken on natural resource economics, legal issues, and international policy debates around environmental taxes and charges. The advice was constructed in consultation with an internal reference group, and informed the review of Cabinet submission templates. |
| Department of Treasury and Finance | **Fire Services Funding Review**<br><br>Funding for Victoria's fire service is shared between the insurance industry, the state government and municipalities. To recoup its contribution, the insurance industry applies a loading to all insurance policies with a fire risk element (the Fire Services Levy).<br><br>The review was requested by government in response to a number of issues raised by stakeholders, including a perceived lack of equity in the system and the impact of the funding arrangements on decisions on whether or not to insure property against damage from fire. |
| Department of Infrastructure | **National Roads Strategy in Victoria – Forward Strategy 2003-04 to 2007-08**<br><br>This project identified the investment priorities for developing that part of the Victorian roads network for which the federal government makes a full or partial contribution (National Highways and Roads of National Importance).<br><br>The strategy must be prepared annually as a condition of federal funding. |
| Department of Infrastructure | **Northern Central City Corridor Study**<br><br>This project was a study on Melbourne's Northern Corridor (Eastern Freeway to Tullamarine Freeway) to review and document existing and projected transport needs, and the related community and environmental impacts. It identified and evaluated options to meet transport needs and manage impacts including traffic, road, public transport and urban design measures. |

*Source:* Victorian Auditor-General's Office.

## Were issues, scope and policy objectives clearly defined?

The first step in developing policy advice is clearly defining the issue – what is the problem to be solved, what are the limits of the issue under consideration and how will you know when you have solved the problem?

Policy problems are not always clear, separate or stable. Without clear definition of the core issue, the scope, and the objectives of the response, there is a risk that the actions recommended to government will only partially address concerns or go much wider than required.

Decision-making criteria (the way that alternative policy options will be compared), also need to be defined. Clear statements of decision-making criteria add to the transparency of the process, and help make policy recommendations more defensible. The process of defining these criteria also helps make the assumptions, values and beliefs that underpin the policy development work[15] explicit.

While issue, scope and decision-making criteria need to be identified as early as possible in the process and documented, this does not mean they cannot (and should not) be reviewed and refined as more information becomes available. We discuss this later in this article under Section 3.1.5.

In assessing the way policy development projects managed issue and objective definition, we considered whether:

- the core issue and the scope of the project was clearly defined and documented
- the desired outcomes of the policy being developed were identified, along with any assumptions and constraints (such as time limits)
- criteria by which the feasibility of various options would be assessed were developed and stated. These decision-making criteria should be informed by the issue and scope, and the relative importance of each criterion identified.

### Defining the core issue and scope

In the projects we examined, this aspect of policy development work was done well. In the smaller projects, the core issue and scope were clear from the start and well-defined.

In the case of major reviews (for example the Fire Services Funding Review and the Northern Central City Corridor Study), one of the challenges in defining the core issue was controlling the project scope. Successive meetings with government and non-government stakeholders were essential in order to fully understand the issue, but each of these consultations could potentially enlarge the scope of the project as stakeholders identified issues that they felt should be addressed within the project. This created the challenge for the teams of achieving a balance between addressing the issues raised by stakeholders and planning a manageable review.

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[15] For example, a project investigating options for improving the safety of older drivers may develop evaluation criteria that consider not only how they can reduce the number of road crashes that older drivers are involved in, but how they can protect the mobility of older people in the community. A key assumption in this case is that maintaining the mobility of older people is as important as protecting them from injury.

Projects we examined met this challenge by developing clear statements of the terms of reference of the review, which defined areas inside and outside the scope. The Fire Services Funding Review did this particularly well, identifying the likely areas where there would be pressure from stakeholders to extend the scope of the review in advance. Clear terms of reference were developed, setting out the major areas excluded from the scope of the review. These terms of reference were developed with, and signed-off by, the minister before major external consultations commenced.

Internally, where issue and scope needed direction, project teams followed appropriate practices like progressive internal review. This included regular reports to senior management advising of early findings and recommending progress to the next stage of the project.

### Articulating the desired outcomes of the policy

Projects examined varied in the degree to which desired outcomes were clear at inception. Legislative review projects often had a fairly clear goal, or specific issues had been identified with the legislation. That allowed systematic consideration of the options for amendment.

In other cases, the initial goal had been articulated in very broad terms, and the aim of the project was to develop this in detail. The Northern Central City Corridor Study progressively refined and amended the project objective from the minister's initial announcement of the project to produce a clear statement summarising the goals of the project. This was supported by then identifying a range of goals for the project and the indicators for each of those goals.

### Developing criteria to assess policy options

For the projects examined, the degree to which decision-making criteria were made explicit and the time spent identifying and refining decision-making criteria varied according to the complexity and scope of the issues.

In the case of policy development projects that were purely to implement changes to legislation, the objectives of the required changes were clear, and the range of possible options was small.

In the case of the Northern Central City Corridor Study, the range of possible options, and potential impacts was very large. As a result, developing and documenting a detailed study appraisal framework became essential.

All of the projects examined anchored their project-specific evaluation criteria in a wider framework. For example:

- the policy team for the Fire Services Funding Review based their evaluation criteria on economic theory and linked them to the terms of reference

- the Department of Justice considered all evaluation criteria in terms of "fairness, effectiveness and efficiency"

- the Department of Infrastructure linked its evaluation criteria to triple bottom line categories used in the department's planning.

This process of grounding the decision-making criteria in a wider framework helps build consistency with other departmental policy, and adds to the defensibility of the criteria used.

### Conclusion

Generally, issue and objective definition was done well. Where complex areas were considered, successive revision and refinement of the issue allowed the team to gradually build the definition as their understanding of the issue grew, and as consultations progressed.

## Is option analysis and evidence review rigorous?

There are often a large number of possible courses of action to address a policy issue[16]. Each needs to be considered in terms of the best available evidence on their likely effectiveness, and also on the costs and benefits, social impacts, economic and political implications.

Policy option analysis needs to strike a balance between canvassing as many possible solutions as possible, and meeting resource and time constraints.

Evidence useful for policy advice includes analysis of existing data, pilot studies, stakeholder involvement, reports from other jurisdictions, and academic literature. Using as many rigorous sources of evidence as possible helps move beyond policy advice based purely on conviction or ideology.

The quality of advice depends on the quality of this evidence which, in turn, depends on the integrity of the sources from which it is drawn. A key part of the policy development process is, therefore, identifying the limitations and any qualifiers on available evidence.

Policy option analysis generally includes a consideration of the choice of the appropriate methods or policy instruments to deal with a problem, e.g. is legislation, regulation or program change required?; should government consider financial incentives (or taxes) to change behaviour?

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[16] For example, a policy project aiming to reduce the incidence of drink driving could consider: implementing stronger penalties for offenders; increasing the level of police enforcement; education programs for motorists aimed at changing attitudes; engineering solutions which prevent vehicles being started by drivers with alcohol in their body; or a mixture of measures.

In assessing the way departments managed policy option analysis and evidence review, we considered whether:

- preliminary option evaluation quickly eliminated options which failed to satisfy key criteria, with reasons for rejection documented
- remaining options were considered in detail against evaluation criteria , and appropriate analytical tools were used
- information needs and limitations to available evidence were identified
- a range of policy instruments were considered.

### *Preliminary option evaluation*

Generally, policy development projects commenced with an idea of potential options to address the issue. However, the most effective projects also applied a formal and systematic process of scanning for options. For example, the Department of Treasury and Finance teams used a disciplined process of considering and documenting options, including:

- making no change
- reviewing options used in other jurisdictions
- considering options used in similar industries
- academic theories
- brainstorming for new ideas
- considering stakeholder suggestions.

Applying this kind of discipline forces policy advice teams to consider all options, rather than moving straight to the possible solutions that they are aware of.

All projects examined clearly documented the options considered in the early stages, making it clear to stakeholders and subsequent reviewers how wide a range of options had been canvassed.

### *Considering options in detail*

The processes used to consider options in detail differed according to the project. Some projects required detailed economic and financial analysis, with extensive financial modelling and consideration of a range of scenarios.

The Department of Infrastructure's Northern Central City Corridor study was one of the more complex projects we examined in terms of the potential options that needed to be considered in detail. The wide stakeholder consultation required for a project like this also meant that many options were suggested, some differing from others in only minor details. In order to capture and organise options, the team created an evaluation database to sort possible options into categories. This allowed identification of overlaps and repetitions, and reduced the range of options to a more manageable number.

The Northern Central City Corridor study also modelled a number of scenarios, each considering the impact of various options in different situations.

### Using evidence and research

Use of evidence and research varied according to the scale and purpose of the project. In all cases examined, it was appropriate for the project.

Two of the larger projects examined employed a traditional approach of collating considerable background research into issues and options papers. This makes efficient use of time for new staff joining the project team and external reviewers.

One of the key roles of policy development teams is to identify the limitations of available evidence and research in an area. Emerging research or limited evidence should not necessarily be discounted, but its limitations need to be made clear when it is used to support a recommendation. The Fire Services Funding Review conducted by the Department of Treasury and Finance demonstrated particularly sound treatment of complex and sometimes incomplete or inconsistent data. The limitations of data were recorded in documentation and any assumptions made in calculations were made explicit in footnotes to the report.

As well as conducting their own evidence review and evaluations, a key role for policy development teams is to critically evaluate the claims or submissions provided by stakeholders. In this role, they provide the minister with impartial advice on the strength or limitations of external submissions.

One Department of Treasury and Finance project team conducted this part of their work particularly well, rigorously evaluating research that was being presented by an alliance of stakeholders who were lobbying for a particular policy outcome. The team considered this material in their modelling and analysis activities, and identified fundamental flaws in the work. This process enables government to provide a balanced and informed response to stakeholder submissions.

### Identifying appropriate policy instruments

Good practice in policy management requires that policy developers separate the objectives of policy from the instruments available. When the objectives have been clarified, an important part of the option analysis is a consideration of the appropriate policy instruments to implement the policy. The selection of policy instrument should consider:
- is it appropriate?
- will it be cost-effective?
- will it get the job done?
- will the consequences be fair and equitable?
- is it simple and robust?
- can it be implemented?

A single policy may require multiple instruments for its effective implementation.

The 8 projects examined required consideration of a range of policy instruments – including specific legislation, community education programs and financial taxes/incentives. Generally, the appropriate policy instruments were clear from inception, or determined as part of the project terms of reference.

The Department of Justice used a clear and well-established process to critically consider whether legislation was the appropriate policy instrument for their projects. When stakeholders suggested an amendment to an Act, the team assessed whether the outcome could be addressed through legislative amendment, or some other option.

### Conclusion

The projects we examined had a range of differing research needs. In all cases, leadership by experienced staff played a key role in identifying available information sources and information needs.

The degree to which teams were skilled at critically evaluating submissions by stakeholders external to government (and the degree to which they needed to do this) varied. Not surprisingly (in view of their responsibilities for reviewing other departments' policy proposals), the Department of Treasury and Finance teams showed the greatest skills in this area.

## Is stakeholder engagement managed effectively?

The Victorian Government has made a clear commitment to stakeholder engagement and consultation. A paper prepared for the Department of Premier and Cabinet summarises the government's view on the benefit of stakeholder engagement: "Effectively engaging communities and stakeholders in policy development and implementation is essential for building trust, accountability, common purpose and good service outcomes"[17].

A "stakeholder" is anyone who has an interest in particular policy outcomes[18]. Effective engagement with stakeholders can enhance understanding of the issues, and widen the expertise available to the project team. If stakeholder support can be achieved during the development process, it can also improve acceptance of the eventual policy outcome.

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[17] *Report on international policy trends, Learning about innovation and balance, Improving the productivity, sustainability and fairness of knowledge economies and societies*". Paper prepared for Victorian Department of Premier and Cabinet, November 2001, p. 3.

[18] For example, stakeholders in a policy project to make recommendations to improve school bus safety would include school children and their carers; education staff; private and public transport operators; road safety professionals; local government and road users. All of these groups can potentially inform policy development in this area, and all have a stake in the outcomes.

If stakeholder engagement is not effectively managed, it can create delays and increase the cost of the project. It can also raise unrealistic expectations, allow unrepresentative views to dominate or give a distorted view of community opinion.

In assessing the way departments managed stakeholder engagement for policy development projects, we considered whether:

* robust processes were used to identify the stakeholders in an issue, appropriate ways of engaging these stakeholders and giving them access to the consultation process

* stakeholder expectations were managed by informing stakeholders of the purpose and process of the policy development project, and how their involvement would feed into the decision-making process

* stakeholder views and suggestions were documented and summarised for inclusion in key decision-making documentation

* the risks of stakeholder involvement (such as conflicts of interest or breaches of confidentiality) were identified and managed appropriately.

### Identifying and engaging with stakeholders

The needs for stakeholder involvement varied in the policy development projects examined. Policy development teams consulted in a range of ways, including: requesting written submissions, convening stakeholder reference groups for face-to-face discussions, meeting one-on-one with industry bodies, holding "town-hall" type meetings and issuing discussion papers throughout the progress of the project. The channels of consultation selected balanced the need to provide access with the need to conduct consultation in the most cost and time-effective ways.

Many projects differentiated core and non-core stakeholders in planning for stakeholder engagement. They identified those stakeholders who needed input, interest groups who needed to be consulted and those who just needed to be kept informed. This made consultation processes more structured and manageable.

Departments frequently had a network of key stakeholders with whom they regularly consult, but projects with wide community impact also tried to establish opportunities for other interested groups and individuals to self-identify. They did this by publicly advertising the project or review.

However, the process of identifying and involving stakeholders can be brought into question if clear selection criteria are not established. In one case examined, key parties were invited to suggest representatives for a community reference group. One stakeholder identified through this process was excluded from the community reference group. No reason for the exclusion was given, creating tension with the body excluded, and placing the credibility of the consultation process at risk with all stakeholders.

Clear documentation of the basis for selection of stakeholder representatives and the decision-making process for selection would help prevent this kind of action, and protect the credibility of consultation processes undertaken.

Teams examined did not always document their plan for stakeholder engagement. Even in small projects, a brief plan identifying stakeholders to an issue, the extent of their interest, and how and when they will be consulted builds transparency and assists with project management. Some of the projects we examined did not fully recognise the costs and time impacts of stakeholder engagement. Formal planning for stakeholder engagement would have identified this constraint early in the project.

### Managing stakeholder expectations and keeping stakeholders informed

All projects examined had a sound understanding of the importance of managing stakeholder expectations. The projects with a large consultation commitment provided stakeholders with clear statements of the terms of reference of the policy development process and their involvement.

At least one of the projects examined had to manage stakeholder expectations that had been generated by a previous review. The earlier review had been conducted by independent consultants, and had made recommendations that exceeded the scope of their (the first project's) brief. Again, clear statements of the terms of reference of the review assisted in managing this process.

Where wide community consultation was required, managing expectations can be difficult – the Department of Justice community consultation sessions on chroming were conducted as "information sessions" rather than "consultation sessions". This provided the teams with an opportunity to gauge community response without generating expectations that all suggestions/issues raised at the forum would be considered.

### Documenting stakeholder input

Accurately documenting stakeholder input and contacts is important to ensure transparency and as evidence in informing policy advice.

We found that by the end of the consultation process, all policy advice briefs listed stakeholders consulted. They also summarised stakeholder views, both positive and negative, and provided detailed information to the minister and government on the range of views held on issues.

The process of documenting stakeholder input during the policy development process was not always so systematic – one-on-one meetings with stakeholders were not always documented. This tendency not to minute meetings, and inconsistency about when meetings were documented, is discussed later in this article.

Many projects with a wide public consultation process also made stakeholder submissions available publicly, as for example the Fire Services Funding Review and the Northern Central City Corridor study. This is an important mechanism to assure stakeholders that their views have been heard, and it can also extend and enhance the debate on issues.

### Managing the risks of stakeholder involvement

In order to effectively engage with stakeholders it is sometimes necessary to divulge sensitive information, and to enter into discussions with stakeholders who may have a potential conflict of interest.

The projects examined reflected an awareness of the risks of stakeholder engagement, and tended to minimise information divulged rather than relying on mechanisms such as declarations of interest or confidentiality agreements to mitigate risks.

### Conclusion

Effective consultation is a key success factor in the development of policy. It ensures the policy is adequately informed, and assists in the final acceptance of policy recommendations. Poor or inadequate consultation can significantly increase the risks to the project, and damage the credibility of even fundamentally sound policy recommendations.

All projects examined had a strong commitment to consultation but some would benefit from better planning. A disciplined process of planning systematically identifies stakeholders, the level of their interest in the issue and key strategies for consultation. Without such systematic planning, there is a risk that projects will only consult with familiar and easily accessible interest groups, and that "difficult" stakeholders will be avoided. Formal planning for stakeholder engagement also identifies the time and cost commitment required.

Some projects examined were more effective at planning how they would communicate project outcomes and decisions than at planning to get stakeholder input at the front-end of the project. The tools and methods of communicating project outcomes are generally very familiar to public sector staff, while ways of gaining front-end input and consulting are less familiar.

## Recommendation

**43.  That departments implement formal planning (appropriate to the size of the project) for stakeholder involvement in policy development incorporating:**

- **clear statements of the purpose and goals of consultation**
- **a structured identification process for who to consult**
- **identification of the most appropriate consultation channels for stakeholder groups**
- **evaluation of the effectiveness of the stakeholder engagement process.**

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

*DTF agrees with the recommendation and notes that the extent of formal planning should be appropriate to the size and complexity of the project. DTF is committed to stakeholder involvement in policy development and currently undertakes consultation on a regular basis. The introduction of a formal project management methodology will strengthen this practice within DTF.*

## Is government coordination in policy development effective?

Modern government is complex and a particular piece of policy advice can cut across departmental and government boundaries, and involve many parties in its delivery. It can also affect, and be affected by, other policies.

Because of this complexity, it is essential that policy officers identify other government stakeholders and other policies that will impact on, or be impacted by, the policy brief being developed. This consistency with other policies and the objectives of other government departments is not always easy to achieve. It can take considerable negotiation and option exploration.

It is also important that policy development occurs with a view to program implementation – coordination with program delivery staff at the policy development stage adds to the robustness of the policy recommendations.

In assessing the way policy development project teams managed government coordination, we considered whether:

- related policies (existing and emerging) and key government stakeholders were identified
- protocols for working with other government stakeholders were developed and communications kept them informed.

### *Identification of related policies and government stakeholders*

Identification of related policies was of a good standard in the samples examined. The submission templates used for submissions to Cabinet require that the relationship between the policy being developed and other policies be identified.

This identification of links to other policies considered both horizontal and vertical relationships. Related policies in other departments were identified, as well as relationships with higher-level policy such as *Growing Victoria Together*.

### *Working with other government stakeholders*

Protocols require that all Cabinet submissions are supported by sign-off from other departments that they have been adequately consulted. As a result, by the time the policy development projects examined had been completed, an effective consultation process had been undertaken.

However, the efficiency with which projects reached agreement with other departments varied. Given the size and complexity of departments, it was often difficult to know who should be involved. In some projects, a number of areas in another department needed to be involved, and divisions within the same department did not always express cohesive views.

In the case of the Department of Justice project on guardianship, 2 different parts of the Department of Human Services (DHS) needed to be consulted. These areas were consulted separately, and sometimes expressed differing views. Clear protocols established early in the project (for example an exchange of letters between the Secretary or Deputy-Secretary of the 2 departments, or nomination of a single departmental contact officer) may, on occasion, be beneficial in achieving coordinated responses to complex issues.

The ongoing involvement of other government stakeholders in all the samples ensured that their issues and views were considered during the project. Overall, the relationships were positive and the teams worked well with their government partners.

All teams experienced some political and/or policy position tensions from their government stakeholders during the process. These were resolved in the same ways that tensions in stakeholder consultations were addressed – through formal and informal negotiations.

One of the Department of Justice teams worked particularly well across several government agencies under tight time lines. The volatile substances team established a Protocols Advisory Committee and clearly mapped out relationships/interaction between different stakeholders. This brought stakeholders together and established and maintained good relationships throughout the project as well as after legislation was passed in order to implement the amendments.

### Conclusion

Effective management of government coordination was a key success factor for all projects examined. Generally, all policies examined performed well against this criteria. The Cabinet guidelines ensured good consultation with other Victorian public sector departments.

Government coordination was generally achieved by the end of the project. As with stakeholder engagement, clear front-end planning for who needs to be consulted, and identification of protocols for this consultation will assist.

### Recommendation

> **44.** **That projects identify key departmental consultation partners, and establish agreed processes for consultation at the outset of the project.**

> ### RESPONSE provided by the Secretary, Department of Treasury and Finance

> *DTF agrees with the recommendation and notes that the extent of consultation should be appropriate to the size and complexity of the project.*

## Was the relevant minister kept informed?

A policy adviser's key clients are ministers and government, and ministerial briefs support these clients in making key decisions about policy directions. Developing policy advice is usually an iterative process – initially information may be incomplete or objectives unclear, and policy analysts develop options, test them against ministerial opinion and progressively refine them.

Identifying key stages in the policy development project at which the minister should be consulted can prevent the team from progressing options that are unacceptable to the minister/government (or from incorrectly assuming that an option will be unacceptable).

The responsible minister should also be briefed about key developments in the process.

Final advice to the minister should provide sufficient information on options, identify the limitations of any background information and provide information on risks and mitigation strategies.

Contacts with the minister need to recognise that ministers have time constraints – they need to be accurate, informative but present information in ways that allow for the key elements to be considered quickly.

In assessing the way departments managed consultation/briefings with the minister during policy development projects, we considered whether:

- the minister was kept informed throughout the process. This includes seeking the minister's agreement on the definition of the issue and its scope, informing them of any developments throughout the process and responding appropriately to ministerial requests
- advice was clearly presented in accordance with ministerial and government requirements, and provided clear recommendations stemming from logical and objective argument supported by evidence
- the minister was informed of risks and mitigation strategies associated with the policy options presented
- advice and direction received from the minister during the project is documented.

### *Keeping the minister informed and responding to requests*

All project teams examined provided the minister with a number of written briefings during the process. In all cases, the writing was clear and concise.

The Department of Treasury and Finance and the Department of Justice used a "telescoping" format for ministerial briefs, placing the most relevant issues first and providing background material as an appendix. This is an effective form of communication which allows readers to read only as much material as they need to. The briefs produced by the Department of Infrastructure used a more narrative style. Ultimately, the decision on the preferred style for written briefs is the minister's. Later in this article, we discuss the way that departments monitor their minister's satisfaction with their communications.

In a number of cases, the minister's advice on an issue was needed very quickly. In these cases, sometimes a trade-off had to be made between providing the most up-to-date information and giving the minister enough time to consider the brief. The Legal Policy Unit of the Department of Justice dealt effectively with this issue when presenting complex briefs against tight time lines by providing a draft brief and noting which parts were still being finalised.

### *Providing clear recommendations to the minister and government*

A major objective of policy advice development is to provide advice on options to the minister and government. However rigorous and comprehensive the process of policy advice development is, if the recommendations produced are not clear and unequivocal, then the process cannot achieve this. Advice must be given in such a way that it enables an informed decision-making process.

Policy briefs need to set out clearly the issues considered, and advantages and disadvantages of options. While the policy development team is presenting a brief to the minister and government for a decision, if the department has sound reasons for believing that a particular option is preferred, then the brief should indicate that.

Briefs prepared by the Department of Treasury and Finance and the Department of Infrastructure generally did this well, outlining a number of options, and making clear which option the team recommended as the preferred way forward. In one case, a brief from the Department of Infrastructure outlined 6 options, only one was listed as not recommended. Generally, this is not a particularly useful approach to ministerial briefings, however, in this case the issues considered were complex, and there was still considerable work to do in terms of detailed option analysis, and consideration of issues. The brief advised the minister that the analysis conducted up to that point indicated cautious non-support for one of the options under consideration, but left the way open for further analysis on the other 5 options.

The briefs prepared by the Department of Justice generally presented fewer options, and instead discussed the intent of proposed legislative amendments and invited the minister to request a verbal briefing if more information was required. This was appropriate given the nature of the briefs, which advised on legislative amendments.

### *Informing the minister and government of risks associated with policy recommendations*

Policy advice needs to balance caution against proactivity and innovation. If advice focuses only on low-risk options, opportunities for innovation may be missed. However, it is essential that when the minister or government choose between options, they are fully informed of the level of risk associated with each option and the risk mitigation strategies available.

The Department of Treasury and Finance teams adopted the most consistent and disciplined approach to risk identification in ministerial briefs, advising the minister of risks associated with review findings and options, and recommending mitigation strategies to deal with those risks.

The more recent briefs at the Department of Justice also provided explicit statements of risk in ministerial briefs.

While a consideration of the risk associated with options was integral to the preparation of policy advice in the Department of Infrastructure, ministerial briefs we examined from that department did not always make explicit statements of risk.

### Documenting ministerial direction/advice

As previously discussed, developing policy advice is often an iterative process, with progressive meetings or briefings with the minister where direction is given on particular issues.

It is important to clearly document agreed outcomes of these meetings.

The legal policy unit at the Department of Justice used a template that ensures they maintain a clear trail of the minister's response to each brief by inviting the minister to indicate after each recommendation of briefing "Agree/Disagree/Discuss/Needs further information". This leaves a clear trail of the minister's response to particular issues that is preserved when staff changes occur.

In a number of projects we examined, ministerial advisors were involved throughout the project, participating in formal briefings and providing informal advice and comments by phone and email. The status of this involvement, and whether the advisor was responding on behalf of the minister was not always clear.
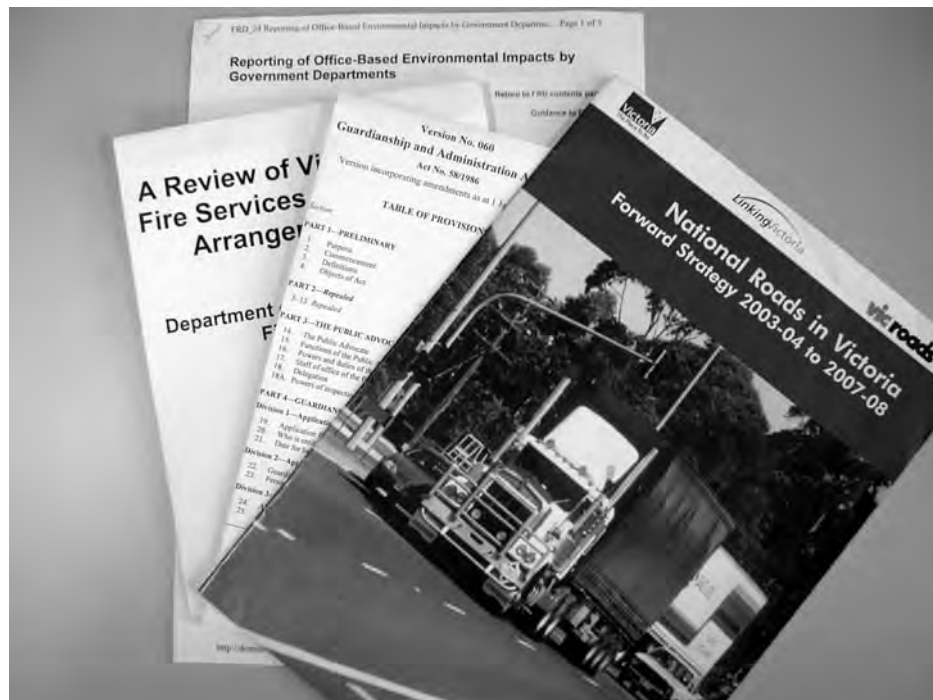


*Products of briefs examined by audit.*

### *Conclusion*

Generally, the way that departments and policy development project teams interact with their responsible ministers will be shaped by the individual preferences of the minister. However, departments can assist by offering clear briefings in consistent formats.

In the samples we audited, the ministers had a high level of involvement in the policy projects. All teams briefed their minister on several occasions and the relationships between the public servants and the minister's office appeared to be constructive.

Keeping the minister informed was generally adequate. In most cases, ministerial briefs from departments were guided by clear protocols and reporting templates assist in consistency.

Contacts with ministerial advisors were sometimes used to assist communication with the minister. Project teams were positive about the contribution made by advisors, however the absence of clear guidelines on their role poses risks. Advice to and from a ministerial advisor about project status and issues cannot substitute for advice to, and direction from, the responsible minister.

While all projects examined considered the risks associated with options and recommendations when they were developing their advice, not all made explicit statements of risk when they briefed the minister. In some cases risks were identified, but not mitigation strategies. Failure to provide clear statements of any risks associated with recommendations can mean that either the minister is not informed, or that the team makes only risk averse recommendations.

### Recommendation

45.    **That advice to ministers should note risks associated with recommended options, and recommended mitigation strategies.**

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

*DTF agrees with the recommendation.*

## 3.1.5 Is the management of policy development projects effective?

Policy development can be complex and demanding – major investigations may have to be coordinated, multiple communications and negotiations may have to occur and issues will arise. The steps in policy development do not always occur in a linear or simple order.

Effective project management is a critical success factor in policy development - "the disciplines of project management provide policy makers with the tools they need to focus on all aspects of good policy making simultaneously"[19].

Effective project management allows a formal and structured approach to policy advice development so that complexity can be dealt with and timelines achieved.

In assessing the effectiveness of project management in the policy development projects examined, we considered whether:

- an appropriate plan for managing the process was developed and documented
- project management disciplines such as ongoing review monitoring and reporting of milestones, risk management and budget control were used
- staff resources and responsibilities were identified and accountabilities within the project were clear
- key documentation was maintained and key decisions were documented – e.g. why were particular options rejected, why were some process features not done throughout the process.

## Project planning and management

Project planning varied in quality, particularly in the areas of budgeting and risk management.

In the case of the Northern Central City Corridor study by the Department of Infrastructure team, a comprehensive and well-documented project plan was developed. The key planning document was made available for public comment, which allowed for broader community consultation about the study. This project also produced the most meaningful budget, which was detailed and linked to time lines and milestones for the project. The Department of Infrastructure project examined was a major project with a significant budget and time line. One of the smaller projects examined (the Department of Justice volatile substances legislation) also demonstrated good planning.

The Department of Justice volatile substances legislation project had only 2 months turnaround between the minister's announcement on 4 March 2003 and the introduction of a draft bill to the Legislative Assembly on 6 May 2003. This project produced a comprehensive project brief (dated 12 March 2003) which covered items such as:

- background and context
- project approach
- project objectives
- project scope (including key issues)
- deliverables

[19] United Kingdom National Audit Office, 2001, *Modern Policy-making: Ensuring policies deliver value for money*.

- assumptions and constraints
- risks and mitigations
- consultation strategy
- project organisation (team responsibilities)
- resourcing
- accountabilities.

In most other briefs examined, planning was less rigorous. Teams at the Department of Treasury and Finance and the Department of Justice conducted planning/brainstorming workshops during the planning phase of their projects. This was effective for generating ideas, identifying opportunities and identifying risks. However, the outcomes of these workshops were not always fully documented.

### Budgeting

Project budgets ranged from no budget at all (beyond a commitment of staff time) to $1.9 million. In the majority of samples, we consider that budgeting could have been improved and used as a more meaningful management and reporting tool. Overall, budgeting was weak.

### Risk management

Approaches to risk management in policy development projects varied. Some projects developed formal risk management plans which identified risks to the delivery of project outputs and outcomes, and developed mitigation strategies.

Others had less explicit identification and monitoring of risks to the project delivery. In the case of the Department of Treasury and Finance environmental taxes and charges project, risks were identified in project planning, but not the risk mitigation strategies.

As discussed in our March 2003 report, *Managing risk across the public sector*[20], formal risk management is a relatively new discipline within the public sector. This was reflected in the fact that generally the more recent projects examined had more explicit and structured risk management processes than earlier projects.

### Evaluation

Project plans examined did not make provision for project review on completion. Evaluation of the lessons learned during a project prevents policy units repeating mistakes in future projects and assists with developing staff skills.

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[20] Victorian Auditor-General's Office, 2003, *Managing risk across the public sector*, Victorian Auditor-General's Office, Melbourne.

If conducted externally, project reviews can also advise whether the policy development was conducted as rigorously as possible. Only one team (at the Department of Treasury and Finance) had their brief externally evaluated, and found it to be a valuable exercise.

### *Identifying staff resources, responsibilities and accountabilities*

Staff skills and knowledge are a crucial element in the success of any policy development project.

The size of the policy teams varied across the agencies (2-10 people involved). All teams experienced fluctuations in resourcing and staff availability. Finding staff who were skilled in the area, and who had the necessary policy and project management skills, can be a challenge.

Two of the teams contracted-in expertise for part of their projects, whereas the others managed their projects internally or by seconding staff from other departments. Where expertise was contracted-in, in one case this was because of a lack of in-house capability. The department tried a number of times to recruit internally and was unable to source the necessary expertise.

One of the large projects at the Department of Treasury and Finance demonstrated effective use of internal staff resources, making use of up to 10 staff who were called in from other areas in the department to provide specific expertise on a part-time basis. As well as ensuring that the project had the skill-set needed, this flexible approach also enhanced the development of the staff involved.

Only 3 of the teams adopted formal reporting lines, whereas the others had more informal arrangements. There were no general guidelines available on this area in the departments examined. The absence of clear protocols on governance and reporting lines is considered later in this article where we discuss skills and methodologies more broadly.

### *Maintaining key documentation*

The standard of documentation maintained in all projects we examined was adequate, but varied in quality across the samples.

Often, teams could be more diligent in minuting meetings. We recognise that often notes will be taken at meetings and not then typed up, however, this can present a risk if key decisions are made or consultations occur and are not properly documented. One team at the Department of Justice approached this problem by recording minutes at all meetings with external stakeholders, while using more informal documentation for routine internal meetings.

### Conclusion

Project management methodologies for policy development can be improved – while it is not necessary to develop large project plans, simple planning templates can provide a disciplined and organised process. The project brief employed by the Department of Justice team provides an example.

Departments need to adopt more formal risk management practices in policy projects.

Stronger provisions for project evaluation could be built into project plans. Such a review should consider whether:

- all relevant issues and options were identified
- advice was clear and comprehensive
- stakeholders were well informed
- key milestones and budget were met
- timelines were followed.

Maintenance of documentation was variable. While there was no critical documentation missing, a consistent approach needs to be taken to issues such as minuting meetings and recording of key decisions.

Many of these issues can be linked to the absence of formal guidelines or methodologies for the conduct of policy development projects in departments. This issue is discussed further later in this article.

### Recommendation

**46. That departments prepare project plans (including budgets, key milestones and evaluation plans) appropriate to the size and complexity of the project and report progress against them.**

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

*DTF agrees with the recommendation and notes that the extent of formal planning should be appropriate to the size and complexity of the project. The introduction of a formal project management methodology will strengthen this practice within DTF.*

## 3.1.6 Capabilities to develop policy advice

As explained earlier in this article, "development of policy advice" covers a wide range of activities. These range from high-level, long-term strategic direction-setting (which may take a long time and need substantial resources), to the very rapid and reactive provision of advice about ad hoc issues that arise.

Government departments need to develop and maintain the capabilities (such as the staff capacity, skills, experience and systems) to engage in that wide and diverse range of policy advice development activities.

By maintaining such capabilities, departments can assure government and stakeholders that when urgent policy advice is required for a rapid response, they can develop high-quality, well-informed policy advice that is consistent with broader government policy.

Such capabilities also require and enable departments to properly manage any contracted external expertise they might use to help develop policy advice.

## How effective was policy advice planning?

The provision of policy advice to ministers and government is a core responsibility of departments. The capacity to deliver high-quality policy advice should be underpinned by departmental corporate, risk and business plans.

In assessing how effectively departments plan to develop policy advice, we considered whether:

- strategic or corporate plans identified policy advice responsibilities
- departmental and divisional business plans identified current and future challenges to policy advice capacity
- departmental and divisional risk management plans identified, ranked and treated risks that related to policy advice.

### *Identification of policy advice responsibilities in strategic or corporate plans*

As Figure 3.1C shows, all 3 departments identified policy advice and development responsibilities in their strategic or corporate plans.

**FIGURE 3.1C: REFERENCE TO POLICY ADVICE IN DEPARTMENTAL PLANS**

| Department plan | Reference to providing policy advice |
| --- | --- |
| Justice Portfolio, Three Year Strategy Plan, 2000-2003 | Each of the department's 5 portfolio outcomes refers to policy advising responsibilities. |
| Department of Infrastructure, Corporate Plan, 2003-06 | The secretary's foreword states "DOI exists first and foremost to provide sound advice to ministers ... it is incumbent on the department to provide timely, robust advice to ministers". |
| | The need for effective relationships with other departments, local government, the Commonwealth Government, industry bodies, private operators and other external stakeholders is also highlighted. |
| Department of Treasury and Finance, Corporate Plan, 2003-06 | A departmental objective is to "guide government actions to best increase living standards for all Victorians through the provision of innovative policy advice". Strategic priorities, major projects and outputs are geared towards achieving this objective. |

*Source:* Victorian Auditor-General's Office, extracted from departmental plans.

### *Identification of policy advice challenges in business plans*

Figure 3.1D shows that divisional business plans in all 3 departments identified the key challenges to policy capability, and the actions to be taken to address them.

**FIGURE 3.1D: CHALLENGES TO POLICY CAPABILITY AND RESPONSES IDENTIFIED IN BUSINESS PLANS**

| Division | Challenges to policy capability | Actions to address challenges |
|---|---|---|
| Department of Justice - Legal Policy Division | An increasing number of Bills.<br><br>More longer-term law reform needs to be addressed.<br><br>Intense budgetary pressures.<br><br>An increasing trend towards national law reform. | Enhance business processes by improving knowledge management systems.<br><br>Improve risk management capability and process re-engineering.<br><br>Identify core skill competencies.<br><br>Improve project management.<br><br>Develop check lists and tool kits.<br><br>Introduce regular project debriefings.<br><br>Improve staff retention. |
| Department of Infrastructure - Planning and Policy Division | Achieving a balance between retaining internal knowledge and accessing external knowledge.<br><br>A need to clarify the division's role and contribution to address current confusion.<br><br>A need to review current processes, structures and policies.<br><br>Leading and coordinating intergovernment, interdepartment and other stakeholder relationships. | Recruitment, retention and development of staff.<br><br>Developing a register of external expertise.<br><br>Compiling a database of existing skills, knowledge and recently undertaken training.<br><br>Conducting a needs analysis on the skills and knowledge required of divisional staff over the next 2-3 years.<br><br>Developing a stakeholder management plan. |
| Department of Treasury and Finance – Economic and Financial Policy Division | Committing to relationship management.<br><br>Providing innovative and forthright analysis.<br><br>Sharing skills and knowledge.<br><br>Promoting diversity and creativity. | Developing a policy skills staff development program.<br><br>Analysing current skills to meet new demands.<br><br>Role clarity initiatives. |

*Source:* Victorian Auditor-General's Office, extracted from departmental plans.

### *Risk management planning*

Two departments – Department of Justice and Department of Treasury and Finance – had formal departmental risk management strategies. The policy divisions of both departments identified and addressed risks in the way required by their departmental plan. Figure 3.1E shows the policy advice risks, causes and treatments identified by the 2 divisions.

**FIGURE 3.1E: POLICY ADVICE RISKS, CAUSES AND TREATMENT STRATEGIES**

| Department | Risk | Causal factors and effects | Treatment strategies | Rating |
|---|---|---|---|---|
| Department of Justice - Legal Policy Division | Failure to deliver agreed legislative program. | *Causes*: Changing political imperatives and priorities, increased national law reform agenda, budget pressures arising from reprioritisation of work.<br><br>*Effects*: Embarrassment to government. | Extensive project planning and management on major projects and parliamentary Bills, improved business processes, knowledge management strategies, tailored training and development. | Low |
| | Provision of poor quality advice. | *Causes*: Insufficient time to consult, consider and advise on external policy initiatives.<br><br>*Effects*: May create further work to rectify original errors, possible departmental embarrassment. | Extensive project planning and management on major projects and parliamentary Bills, improved business processes, knowledge management strategies, tailored training and development. | Low |
| | Loss of corporate knowledge. | *Causes*: Departure of experienced staff and incorrect use of new systems.<br><br>*Effects*: Gaps in knowledge, delays, ineffectiveness and inefficiency. | Improved business processes, knowledge management strategies, tailored training and development.<br><br>Consultation with staff to implement business process improvements, knowledge management strategies, training and development. | Low |
| | Failure to respond to correspondence in a timely and accurate manner. | *Causes*: High priority law reform and policy advice.<br><br>*Effects*: Delays and poor quality responses. | Business process improvement, knowledge management initiatives, organisational restructure. | Low |
| Department of Treasury and Finance - Economic and Financial Policy Division | Advice in briefings lacks timeliness and fails to acknowledge all stakeholder positions. | Not stated. | Extend consultation discussions to consider critical issues when briefs reach the group. Improve time line controls and use more holding briefs to provide initial alert. | High |

*Source:* Victorian Auditor-General's Office, from departmental plans.

Both departments prepared risk treatment plans if risks were rated as medium or high.

The Department of Infrastructure did not have a department-wide risk management strategy. However, it required divisional business plans and individual projects to consider risks. Its Planning and Policy Division's 2003-04 business plan identified one key risk area: the establishment of professional working relationships with other divisions within the department and external agencies. The specific risks in this area were not identified, assessed or ranked, and there was no treatment plan.

### Conclusion

Generally, departments had a good understanding of their policy advice responsibilities, and this was reflected in their corporate and business plans.

Departmental risk management for policy advice was less advanced, with formal risk management frameworks varying between departments.

### Recommendation

> **47.  That the Department of Infrastructure's Policy and Planning Division formalise its approach to risk management.**

## How well were staff skills and methodologies managed?

The skills, knowledge and experience of professional policy staff are very important resources that departments bring to the work of advising ministers and government about policy options. Expert knowledge can be (and is) sourced from outside departments on many issues, but experienced staff ensure that inter- and intra-governmental coordination is managed, and that knowledge about what has (and has not) worked in the past is preserved.

Policy advice expertise increases with experience, and departments need to manage staff succession in order to maintain their capacity to provide quality advice based on expert knowledge, experience and organisational memory.

To develop their skills and provide high-quality advice, staff need practical and useful guidelines, methodologies and tools. These also codify good practice, and help ensure the quality of policy advice is maintained when staff leave.

In assessing how departments managed staff skills and methodologies to develop policy advice, we examined if:

- departments had the current and future skills required to develop policy advice
- professional development was adequate
- departments had methodologies or frameworks for developing policy advice, and related guidance materials were available to staff.

### Skills needs analysis and skills development

All 3 departments examined were in the process of assessing current policy skills against current and future skill requirements.

As Figure 3.1F shows, the Department of Justice's Legal Policy Division was taking action to identify required skills, and to retain appropriately skilled staff.

**FIGURE 3.1F: DEPARTMENT OF JUSTICE, LEGAL POLICY DIVISION, SKILLING AND STAFF RETENTION ACTIONS**

| Action | Background | Audit assessment of the status |
|---|---|---|
| Identifying core skills | Development of a legal officer skill guide based on a 3-stage competency set, namely:<br>• 0-2 years experience<br>• 2-4 years experience<br>• over 4 years experience. | Skills set for legal officers (0-2 years) has been completed.<br>Skill sets for 2-4 years and over 4 years are being developed.<br>Skill guide and core skill identification not yet initiated for project and administrative staffing positions.<br>The division plans to review its core skills identification process in mid-2004. |
| Staff retention | Reducing staff turnover was identified as a key business improvement strategy. Specific actions to address high turnover include better workload management, more flexible working conditions, greater staff confidence, and more consistent and accessible leadership. | Each strategy is being implemented. |

*Source:* Victorian Auditor-General's Office.

At 30 June 2002, 48 per cent of Legal Policy Division staff had been employed by the division for less than a year, and 78 per cent for less than 2 years. This is a significant issue for the division, which considers that for the first 2 years staff are on an "initial learning curve". By 30 June 2003, turnover rates had reduced: 30 per cent of the division's staff had been employed by the division for less than a year, and 55 per cent for less than 2 years.

The Department of Infrastructure planned to identify gaps between current and future skills and capacity (including policy-related skills and capacity). It planned to address gaps through a work force management framework.

The Department of Infrastructure's Planning and Policy Division has 2 main roles: planning and managing policy advice projects, and providing advice to other divisions and agencies. To address the demands of the 2 roles, the division planned in 2003-04 to:

• record existing skills, knowledge and recently undertaken training in a database

- define the skills and knowledge required by staff in the next 3 years
- establish a panel of prequalified consultants to streamline access to external expertise.

At the time of our audit, work had begun on these initiatives.

The policy activities of the Department of Treasury and Finance differ somewhat from those of other agencies. While the department is involved in a range of complex policy proposals, a significant amount of advice is analysis and comment on policies developed by other departments. As a result, much of the department's training and development aims to skill staff to provide high-quality advice about other agencies proposals.

Due to DTF's central agency role and responsibilities in the Victorian public sector, in providing advice on other departments' proposals as well as developing its own complex policy proposals, staff can have fewer opportunities to build their experience in the latter. Consultation with a small group of DTF staff as part of the development of a staff development strategy in 2003 indicated that while there was not a perception that there are significant policy skills deficiencies, there was not a common understanding of what is policy development.

There was, however, a clearer picture of the issues related to skills development requirements, and these have formed the basis of a skills development project aimed at achieving a state of policy excellence.

### *Professional development*

The development of capable policy managers and advisors takes time, formal and informal training, mentoring and opportunities to gain experience (such as secondments).

The policy divisions of the 3 departments identified the training required by staff as part of their annual performance assessment and review processes.

None of the departments had comprehensive training programs that covered all components of the policy advising process. Training was mainly provided through internal and external short courses, conferences and policy-related tertiary courses.

The Department of Justice Legal Policy Division's plans for 2003-04 professional development activities included project management, self-managed learning and coaching.

The Department of Infrastructure Planning and Policy Division's 2003-04 business plan included staff training in project management, risk management and contract management skills. The division previously provided training to staff in public policy development, communication skills, ministerial correspondence, writing skills and preparing Cabinet submissions.

The Department of Treasury and Finance produced a quarterly learning and development calendar listing courses relevant to DTF work. In considering the formulation of future skills development programs focused on policy development there were different views as to the objectives of any skills improvement. VPS staff appeared to have more of a career development focus while executive staff considered that in order to obtain best value from these programs, priority should be given to those aspects that most closely align to the department's responsibilities. The program aimed to meet both objectives by focusing on the:

- principles of good policy (what the policy development framework looks like)
- components of good policy (dissecting the policy framework into its constituent parts).

The Department of Premier and Cabinet has developed a policy skills program for its VPSG 3-6 staff. The program covers policy agenda management, issues analysis, evaluation, stakeholder engagement, communication of policy and project management. The program commenced in March 2004.

### Methodologies and guidance

While the 3 divisions examined had various policy development tools, they had not developed guidelines for staff about how to develop policy advice. Such guidelines would be expected to include the methods by which the main issues (such as roles and responsibilities, protocols, communications and stakeholder consultation) are managed, and the quality assurance and monitoring processes to be followed during and after policy advice projects.

The Department of Justice had a comprehensive range of guidance tools, including its Legal Policy Resource Kit. The kit included information about the:

- division's business, structure and functions
- policy development cycle
- protocols and content structure for executive and ministerial correspondence.

The department's Legal Policy Division also had a guide to preparing draft legislation. It covered some aspects of developing policy advice (such as consultation) but mainly focused on the preparation and passage through parliament of draft legislation.

The Department of Infrastructure's Gateway to Learning and Development Strategy contained some policy advice standards, but they were very broad and did not provide in-depth guidance about the processes to use when developing policy advice.

The Department of Treasury and Finance's Economic and Financial Policy Division developed the Practitioner's Toolkit Program, a seminar series designed to provide practical guidance to more junior staff on those aspects of the policy process most relevant to the department. The department plans to build on this program by documenting and disseminating policy development best practice.

The division has recently identified policy development best practice concepts and tools, and plans to use them in future.

### Conclusion

The departments examined were conscious of the need to manage their human resources to maintain and develop their policy development capacity. While staff turnover rates at the Department of Justice have slowed, they remain high. Efforts to reduce turnover should remain a high priority, and be closely monitored.

The departments examined are providing adequate training in aspects of developing policy advice. However, staff would benefit from a training program that covers the entire policy development process, not just parts of it. Departments should consider adapting the program currently being developed by the Department of Premier and Cabinet.

The departments examined had a range of policy development tools, but only limited formal guidelines about the procedures for preparing ministerial and Cabinet submissions.

In practice, staff receive guidance through the availability of standard submission templates, and through coaching and supervision provided by more experienced departmental officers.

## How well did departments manage policy advice knowledge resources?

Data, information and knowledge are the raw materials of policy advice. The challenge for departments is to identify, maintain and access available knowledge resources effectively and efficiently.

Effective knowledge management facilitates the sharing of available knowledge across an organisation. It involves organisations building an understanding of what information is required, what information is available to them, what information exists elsewhere, what the information gaps are, and how they can be filled.

In assessing how well departments managed their policy advice knowledge resources and the ways that departments manage their knowledge resources required for giving informed policy advice, we considered if:

- departments had developed and implemented knowledge management strategies

- information on available resources was maintained
- sources of knowledge were easily accessible by staff, and there were systems to share knowledge within and across departments
- current information gaps had been identified and future information needs had been incorporated into business strategies.

### Knowledge management strategies

Two of the 3 departments examined (the Department of Justice and the Department of Treasury and Finance) had comprehensive knowledge management strategies. The Department of Infrastructure did not have a formal knowledge management strategy, but had identified knowledge management as a core organisational capability in its corporate plan.

In mid-2002, the Department of Justice conducted a knowledge management audit. The audit identified more than 160 initiatives involving knowledge management. It also found that the department:

- had no knowledge road map
- was failing to tap the energy and potential of the organisation and its people – with learnings often trapped in silos or fallen by the wayside
- was "drowning" in a sea of information and documents.

In response, the department implemented a comprehensive knowledge management strategy. It also developed the Justice Portfolio Strategic Research Plan 2001-05. Since the plan was launched, a number of initiatives have been implemented:

- a research database has been developed. This database can be updated by staff, is able to be downloaded by other organisations, and can be viewed on the department's intranet site
- a research bulletin is produced every 2 months to coincide with the bimonthly meetings of the Justice Statistics and Research Interest Group
- a number of PhD scholarships have been established for students conducting research into priority areas for the department
- the Department of Justice executive group reached consensus on the priority research issues for the department, and monitors projects relevant to these issues.

The Department of Treasury and Finance prepared a knowledge management blueprint and action plan in January 2002. To do so, it benchmarked its knowledge management capability against a best practice model. The knowledge management initiative aimed to:

- improve staff access to sound, relevant and useful information and knowledge

- increase the sharing of information within the department
- establish governance arrangements for the management of information and knowledge.

Eleven projects under the initiative are underway and 8 have been completed, including a departmental portal (an internet/intranet gateway to the department's information and knowledge systems), a staff directory and an electronic collaboration tool.

### Accessing and sharing knowledge

Government departments (and many other organisations) are often better at sharing knowledge upward (through advice to departmental management and the minister) than sideways (with other units). They may also not be as effective at identifying and accessing outside knowledge within their own department or government. This means policy advice staff can miss essential information that is available elsewhere, or duplicate information-gathering work that has been undertaken elsewhere.

We found that the 3 departments we examined recognised enhancing staff awareness of, and access to, knowledge sources as a key challenge. All 3 departments examined had undertaken a number of initiatives to increase staff knowledge of (and access to) information and research resources. Activities included seminars, information guides, email bulletin messages and formal training. They used intranets and the internet to make resources available, and their sites linked to external sources of information (such as the Australian Bureau of Statistics).

Both the Department of Justice and the Department of Infrastructure were exploring the use of "communities of practice"[21] as a way to share knowledge, solve problems and encourage innovation. The Department of Infrastructure Planning and Policy Division 's business plan recognises the importance of information-sharing networks intended to prepare a stakeholder management plan in 2003-04 to improve information sharing. It was also represented on an interdepartmental team considering cross-portfolio policy development and implementation. The Department of Treasury and Finance had performance indicators for its knowledge management strategy. They were:

- management and staff attitudes about the adequacy of knowledge sharing (measured by a staff survey)
- the number of staff attending information forums
- the staff exit procedure (which includes a handover process).

Targets had yet to be set for these indicators.

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[21] "Communities of practice" are groups of people (either from within an organisation or across organisations) with an interest in a particular policy issue.

### Identifying information gaps and planning for future information needs

The 3 departments examined had different approaches to identify and address their information needs.

The Justice Portfolio Strategic Research Plan 2001-05 was the most comprehensive approach. It focused research into areas of identified need to advance the portfolio's knowledge.

The Department of Justice's knowledge management strategy included review and evaluation milestones. Its Legal Policy Division's business improvement strategy identified information gaps. It planned to address these gaps by establishing an electronic records management system, by upgrading its library database, by improving documentation on precedents and by improving its intranet.

The Department of Infrastructure's 2002-05 corporate plan included the development of a 3-5 year research strategy as a planned initiative. Work on the strategy started in 2002. However, at the time of our audit, the project had stopped. We were advised that the loss of a key staff member had stalled the project and it was uncertain if it would continue.

At the time of our audit, the Department of Treasury and Finance was conducting a survey of staff to identify:

- their information and research needs
- their current information and research skills
- how a centralised information and research service could help staff produce more innovative policy advice
- currently available information services and how well they meet staff needs.

The department expects the survey report to make short, medium and long-term recommendations about addressing information needs.

### Conclusion

All 3 departments saw the need to improve information and knowledge sharing within and across departments as a key challenge.

Their progress in meeting this challenge varied. The Department of Treasury and Finance and Department of Justice have implemented knowledge management strategies. These have not yet been subject to a post-implementation review.

The Department of Infrastructure does not have a formal knowledge management strategy although its corporate plans for 2002-05 and 2003-06 include steps to improve knowledge management and research services. It also has several knowledge management initiatives underway. However, a formal knowledge management strategy would systematise its approach. Formally documented processes also offer the benefit of making knowledge management work undertaken accessible to other departments.

## Recommendations

48.    **That the Department of Infrastructure and the Department of Justice evaluate their knowledge management strategies.**

49.    **That the Department of Infrastructure implement a formal knowledge management strategy or department-wide framework to systematise its knowledge management initiatives.**

### RESPONSE provided by the Secretary, Department of Justice

*In accordance with recommendation 48, the department will be conducting an audit of its Knowledge Management Strategy during the course of this financial year.*

## How effective was quality management and evaluation?

Public sector agencies need to measure and be accountable for the quality, cost and timeliness of policy advice. They should also evaluate their policy advice processes, to recognise and improve on poor practice and extended good practice more widely. Evaluation should be built in to new processes; existing processes should be reviewed to ensure they are delivering the desired outcomes; and lessons learned should be available to all staff.

In assessing the effectiveness of quality management and evaluation of policy development, we considered whether:

- measures of quality, quantity, timeliness and cost are established for policy advice activities
- stakeholder satisfaction with the quality of policy advice is monitored
- review and evaluation processes were built into policy development activities.

### Measures for policy advice

Policy advice measures can be at the departmental level (in annual reports or budget papers) or at the division or branch levels.

The Department of Treasury and Finance and the Department of Justice have output measures for their policy advice functions reported in the state budget papers. The Department of Justice reports on the number of hours of policy advice, whether advice meets internal quality standards and whether timelines and milestones are met. The Department of Treasury and Finance reports against its Ministerial Survey "service provision rating". The rating measures the minister's satisfaction with the quality, usefulness and timeliness of the services provided by the department.

Internally, approaches to measurement and of policy development varied. Figure 3.1G shows the performance indicators and targets in divisional business plans for 2003-04.

**FIGURE 3.1G: DIVISIONAL BUSINESS PLAN PERFORMANCE MEASURES AND TARGETS FOR DEVELOPING POLICY ADVICE**

| Division | Performance measures for policy advice | Performance targets |
|---|---|---|
| Department of Justice, Legal Policy Division | Advice is accepted and used. | No targets. |
| | All relevant issues and options are identified. | |
| | Advice is clear and comprehensive. | |
| | Stakeholders are well-informed. | |
| | Advice is provided when needed. | |
| | There is minimal rework. | |
| | Key milestones are met and timelines followed. | |
| | Advice is accepted and used. | |
| | There are no surprises. | |
| | The Attorney-General is fully informed. | |
| Department of Infrastructure, Planning and Policy Division | (No performance measures relating to developing policy advice.) | No targets. |
| Department of Treasury and Finance, Economic and Financial Policy Division | Guide government actions to best increase living standards for all Victorians through the provision of innovative policy advice. | Service provision rating of 80 per cent or greater from the minister. |

*Source:* Victorian Auditor-General's Office.

The Department of Justice reported quantity, quality, timeliness and cost measures for its legal policy output. As Figure 3.1G shows, the Department of Justice's Legal Policy Division also had performance measures for policy advice processes, but did not have targets for these measures. They were used more to encourage good performance by staff than to measure the quality of the development process.

The Department of Infrastructure's Planning and Policy Division does not have quantity, quality, timeliness and cost performance measures for developing policy advice. The division's 2003-04 business plan reported against milestones for planned divisional projects.

The Department of Treasury and Finance had quantity, quality and timeliness performance measures for specific outputs, as required in the budget papers. The measures applied to the work of the Economic and Financial Policy Division.

### *Monitoring satisfaction with policy advice*

Policy development units provide advice to a number of stakeholders including their minister, minister's chiefs of staff, departmental secretary, deputy secretary, other units within the department and elsewhere in government. Understandably, units which monitored stakeholder satisfaction were most concerned with monitoring the satisfaction of ministers with the advice they provided.

The ways that they monitored stakeholder satisfaction varied: the Department of Treasury and Finance uses a "Service Provision Ratings" indicator. Each quarter, the secretary of the department asks the portfolio ministers to rate on a scale from one to 5 their satisfaction with the quality, usefulness and timeliness of policy advice services. This process includes the provision of specific qualitative feedback to each policy advising unit, and can include feedback from the minister on the quality and usefulness of specific pieces of policy advice.

Before 2003-04, the Legal Policy Division of the Department of Justice did not formally measure the satisfaction of the Attorney-General or other internal stakeholders with policy advice and law reform services. The Attorney-General provided feedback through informal discussions. In early 2004, the Attorney-General, the Attorney-General's chief of staff, the secretary of the department, the Deputy Secretary (Legal and Equity) and division staff provided satisfaction ratings for the first time: they will do so twice a year in future. Measures of satisfaction are closely aligned to the performance measures in the division's business plan.

### *Review and evaluation*

Only the Department of Justice's Legal Policy Division had a structured debriefing process for reviewing policy development projects. Its 4-step debriefing process considered:

*   what happened during each policy advice process
*   what insights could be drawn
*   what could have been done differently
*   what were the major lessons learned.

The Department of Treasury and Finance and the Department of Infrastructure did not have formal guidelines about debriefing. It was up to each policy advice team to decide whether they debriefed or not.

The Department of Treasury and Finance often subjects policy advice projects to internal and external peer review.

## *Conclusion*

Most areas we examined had only simple measures covering the quantity and timeliness of policy advice. Policy units had basic measures of client satisfaction, to indicate whether key clients were satisfied with the quality and timeliness of their work. While all placed a great deal of emphasis on measuring the minister's satisfaction with the quality of advice, there was less evidence that they regularly monitored the satisfaction of other stakeholders with the quality of advice.

By adding peer or expert review processes, units would strengthen their assurance that policy advice is robust. They would also obtain an independent opinion about whether the policy advice developed is based on sound evidence, is clear and logical, and canvasses relevant options.

## Recommendations

> **50. That departments develop and implement formal review processes for policy advice development.**

> **51. That the Department of Infrastructure develop and implement cost, quality, quantity and timeliness measures for policy advice.**

### *RESPONSE provided by the Secretary, Department of Treasury and Finance*

#### *Recommendation 50*

*DTF agrees with the recommendation and notes that the extent of the review process should be appropriate to the size and complexity of the project. The introduction of a formal project management methodology will strengthen this practice within DTF.*

#### *General comment*

*DTF has identified the opportunity to strengthen its project management processes. The Project Management Methodology Implementation Project, drawing upon the PRINCE2 methodology, is being rolled out across the department in 2004-05. This will support staff through the provision of outputs including a project management manual or guide, tailored templates, an online library for all project management reference documentation, and targeted training courses. A Project Support Office will be established as a Project Management Methodology Centre of Excellence. This initiative will interface with existing risk and change management procedures.*

*The department expects to enjoy the following benefits:*

- *a standard, consistent management framework which is flexible enough to be applied to all projects, regardless of size and complexity*
- *clarity of terminology, ownership, and responsibility leading to clear direction and decision-making*
- *learning from experiences, both good and bad, for the ongoing development of project best practice*

### RESPONSE provided by the Secretary, Department of Treasury and Finance - continued

- *improved methods for resource planning and coordination, leading to high visibility of project resources and effective scheduling*

- *enhanced quality control, resulting in standardised, quality assured project activities and outputs*

- *improved definition and justification of required project outcomes, resulting in projects that meet target outcomes*

- *enhanced stakeholder communication, leading to outcomes that meet customer requirements.*

*The department has also recognised the need to deepen existing relationships with stakeholders and strengthen the department's stakeholder management culture. This is being targeted through a project called "Easy to Do Business With". This focuses on sharing relevant information and working together with key stakeholders in other departments to achieve better outcomes for government.*

### RESPONSE provided by the Secretary, Department of Justice

*The Department of Justice welcomes this timely examination of the difficult process of policy development. The report recommends that the development of good policy advice is dependent on a range of management strategies and processes, the vast majority of which have been implemented in the Department of Justice in recent years.*

*The department supports the report's argument that good policy development is built upon a consistent knowledge of processes, a commitment to project and risk management, and increased capability achieved through staff retention and professional development.*

*The department supports the report's contention that good policy development is dependent on the adoption of detailed research, planning and knowledge management strategies. These disciplines are well established in the department.*

### RESPONSE provided by the Secretary, Department of Infrastructure

*The Department of Infrastructure acknowledges the considerations contained in the report, which may benefit the development of policy advice. Advice delivered by the Department of Infrastructure should be considered within the context of the department's processes and mechanisms for development and delivery, including the following:*

- *the role of the Planning and Policy Division being a body charged with integrating policy development undertaken by other divisions within the department over a broad range of expert policy areas, such as transport, energy and ICT*

### RESPONSE provided by the Secretary, Department of Infrastructure - continued

- *the role of the department's formal review processes and documented guidelines, including the Project Review Committee, risk analysis and business case development and the Planning and Policy sub-committees of the Management Committee.*

*These processes and mechanisms are described in the department's response to the report recommendations outlined below.*

*The Department of Infrastructure is committed to improving its internal and external policy development processes, its approach to knowledge management and its capacity to develop and retain skilled staff. As noted in the report, these issues are acknowledged in the department's corporate plan and are keys to maintaining and developing the department's ability to effectively deliver outcomes.*

*The Department of Infrastructure offers the following comments on the report's recommendations.*

### Recommendation 43 - Formal planning arrangements

*The Department of Infrastructure agrees that the Northern Corridor Study was a complex project with a wide range of options. It should be acknowledged that the process of documentation and modelling utilised by the department, and noted in the report, incorporates the experience, research and analysis undertaken by the department, agencies and the broader research community over a number of years. Transport projects, in particular, reflect the nature of a network with options in one geographical space impacting on other areas and the consequent need for local knowledge and rigorous analysis. The department's approach explicitly incorporates these factors.*

### Recommendation 44 - Departmental consultation partners

*The Department of Infrastructure's projects identified key departmental consultation partners. The department has established a methodology for the development of policy advice, as evidenced by the internal and external consultative processes used in the projects reviewed by the Auditor-General's Office for this audit.*

### Recommendation 45 - Advice to Ministers should note risks

*The Department of Infrastructure agrees that advice to ministers should note risks associated with recommended options and that mitigation strategies should be recommended. The report acknowledges the number of potential options that complex planning projects can give rise to, and the need for detailed development. The Department of Infrastructure does not preclude options prematurely at the planning stage when these require further development. As noted above, the Department of Infrastructure has a formal project review process which includes a detailed analysis of options and risk.*

### RESPONSE provided by the Secretary, Department of Infrastructure - continued

#### Recommendation 46 - Departments should prepare project plans

*The Department of Infrastructure agrees that project plans, including budgets, key milestones and evaluation plans which are appropriate to the size and complexity of the project, together with progress reporting against the plan should be prepared. The department's business plan reporting system, budget management system and fortnightly report are all mechanisms deployed by the department to achieve sound managerial planning, control and reporting of projects. The department believes that policy advice development encompasses elements in addition to the project management aspects detailed in this section of the report.*

#### Recommendation 47 - Planning and Policy formalise its approach to risk management

*Risks for policy advice projects undertaken by the Planning and Policy Division were not considered to be material risks for the department. The Department of Infrastructure assesses risk by project and a rigorous project risk assessment forms part of the department's Project Review Committee process. Risks are also ascertained by the department's Planning and Policy Sub-Committees; managed via the mechanisms for planning, controlling and reporting for projects; and also highlighted by the internal and external consultative processes previously noted in the department's response to this report.*

#### Recommendations 48 and 49 - Department of Infrastructure evaluate their knowledge management strategy and implement a formal department wide framework to systematise initiatives

*The Department of Infrastructure's approach to knowledge management recognises that on-going knowledge management activities must be both aligned with, and facilitate development of the following key elements required for government to deliver effective outcomes - capabilities of staff and supporting systems required to enable knowledge sharing to become integral to the way in which the department delivers outcomes. To achieve this, knowledge management in the department focuses on the identification of Knowledge Based Business Initiatives and the promotion and delivery of recommended solutions.*

#### Recommendations 50 and 51 - Departments implement formal review processes for policy advice and the Department of Infrastructure develop and implement cost, quality, quantity and timeliness measures for policy advice

*The Department of Infrastructure agrees to develop and implement formal review processes for major policy advice developments and the development and implementation of quality and timeliness measures for policy advice, where appropriate. However, Planning and Policy Division's role as an integrator of policy between department divisions and agencies does not make quantity or cost measures for policy advice applicable.*

## 3.2 Progress by the Environment Protection Authority in addressing the recommendations of our performance audit report, *Managing Victoria's air quality*

### 3.2.1 Background

The Victorian Environment Protection Authority (EPA) is responsible for managing Victoria's air quality and for achieving air quality commitments in national agreements and state policies.

In 2002, we conducted a performance audit of how the EPA manages Victoria's air quality. We concluded that ambient air quality[22] had improved significantly in the preceding 30 years and that Melbourne's air quality compared favourably with air quality in other Australian and overseas cities. Despite this, there were still 300 to 400 deaths and about 1 000 hospital admissions each year related to Melbourne's air quality. The audit found that the EPA had controlled emissions from major industry and was also in the process of controlling pollution from motor vehicles, small-to-medium enterprises and diffuse sources such as wood heaters.

A number of the findings and recommendations of our 2002 report related to the EPA's internal corporate governance practices.

Broadly, the audit report recommended that the EPA:

- improve the information basis of its planning and resourcing practices and decisions
- develop an equipment acquisition and replacement strategy, and improve data collection practices to ensure high-quality data
- maximise the benefits of its air quality management activities, by formalising working arrangements with other agencies, completing its marketing strategy, evaluating the effectiveness of its activities and reporting adequate air quality information.

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[22] Ambient air means the outdoor air environment. It does not include the air environment inside buildings or structures.

## 3.2.2 Audit conclusion

The EPA has implemented some of the recommendations made in our 2002 performance audit. It has:

- initiated improvements to its planning and resourcing practices, as part of a move towards improved corporate governance within the agency
- made significant progress in addressing the recommendations to ensure that quality data are available
- improved its external reporting practices.

However, there has been little or no progress in:

- establishing formal arrangements with key agencies
- developing a marketing strategy
- evaluating the effectiveness of each of the major activities it undertakes to improve air quality
- monitoring and reporting internally on progress in implementing the State environment protection policy (Air Quality Management) attainment program[23].

We believe that the EPA needs to improve its practices in these areas, and have made a number of further recommendations in this follow-up report.

## 3.2.3 Improving the information basis of planning and resourcing decisions

In our 2002 audit, we were unable to see how the EPA decided how much to spend on each area of its responsibilities (such as protecting the air, water and land environments). Further, we could not see how decisions were made about the allocation of resources between activities to reduce pollution and activities to monitor air quality.

In assessing whether the EPA has improved the information basis of its planning and resourcing decisions, we expected to see evidence of the information and rationale used to support resourcing and budget allocation decisions, as part of corporate and business planning. We also expected to see clearly documented decisions.

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[23] The attainment program is the program of activities to be undertaken by the EPA, other government agencies and industry to improve air quality.

The EPA has introduced a corporate governance group to its organisational structure since our 2002 audit. The agency acknowledges the need for good governance in its *Corporate Plan 2003-2005*, stating: "Good governance is not just about our corporate systems and processes, but how decisions are made, implemented and communicated … To deliver our mission to Victorians, we seek to ensure that our decision-making and program delivery is transparent, ethical, rigorous and accountable".

The EPA's 2004 *Strategic Plan – Reach to a Sustainable Future* sets out its strategic objectives and priorities for the next 5 to 10 years. The strategic objectives and priorities were identified through research and consultation with stakeholders and staff.

The EPA produces a 3-year corporate plan (*Corporate Plan 2003-2005)* and an annual budget for the whole agency. The EPA is initiating improvements to its corporate planning and annual budgeting approach.

The information basis for business planning by air quality business units has improved since our 2002 audit. Project proposals for the 2004-05 business plans identify project costs, risks, performance measures, and how the project contributes to achieving strategic objectives and priorities. The proposals show how the EPA is planning to carry out and fund its air quality monitoring activities in the Melbourne-Geelong and Latrobe Valley airsheds, rural regions[24] and local areas, in the medium-term.

The proposed initiatives in the business planning process are considered by the executive team and prioritised according to the degree to which they contribute to the goals in the strategic plan. Issues considered and decisions made in this process were documented through meeting minutes.

The EPA is also developing a 2-year plan to meet the initial requirements of the national agreement for monitoring toxic air pollutants in local areas, finalised in April 2004. The EPA uses selection criteria and an approval process to decide which other local pollution hotspots to monitor.

## Conclusion

The EPA has improved the information basis for its strategic and corporate planning across the agency, and its business planning within air quality business units. It has also improved the documentation of the planning and resourcing decisions it makes during its corporate planning and annual budgeting processes across the agency.

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[24] The rural regions are Ballarat, Bendigo, Mildura, Shepparton, Warrnambool and Wodonga.

**RESPONSE provided by Chairman, Victorian Environment Protection Authority**

*EPA agrees with the conclusion that it has improved the information basis for its strategic and corporate planning, and its business planning for air quality, and the documentation for decision-making as part of these processes. Consistent with EPA's Strategic Plan, EPA will continue to make improvements to its corporate governance.*



*Industry can be a highly visible source of air pollution.*

## 3.2.4 Ensuring quality data are available

In assessing whether the EPA has made progress in implementing our recommendations about ensuring that air monitoring data are high-quality, we expected to see:

- an equipment acquisition and replacement strategy
- national accreditation for air quality monitoring by the EPA's mobile laboratory
- updated emissions inventories.

At the time of our 2002 audit, the EPA did not have a strategy to acquire, replace or fund equipment to monitor air quality. Because some equipment had failed, or required maintenance or repair, the EPA was not able to meet its annual data capture target. As a result, it did not have enough data to show whether air quality in the Melbourne-Geelong and Latrobe Valley airsheds complied with all of the national air quality standards.

The EPA improved its data capture rate in 2003, although it did not meet its annual data capture target.

The EPA is deciding how to fund capital equipment purchases and operating costs for the next 3 years to meet its current monitoring requirements, and in some cases increase monitoring, in the Melbourne-Geelong and Latrobe Valley airsheds, rural regions and local pollution hotspots. It is also considering how to meet additional equipment needs arising from the recent national commitment to monitor toxic air pollutants.

The EPA now has 2 mobile air monitoring laboratories. The air quality monitoring performed by both laboratories is nationally accredited.

The EPA has updated its emissions inventories to include new emission sources, and has improved its emission inventory software.

## Conclusion

The EPA has made significant progress in implementing the recommendations in our 2002 report about making improvements to ensure that quality data are available. The EPA needs to continue to improve its asset management, to ensure that the air monitoring network remains sustainable and that air quality data capture targets can be met.

### Recommendation

52. **That the EPA finalise and implement an asset management strategy to replace, acquire and fund equipment to meet current and emerging monitoring needs for the Melbourne-Geelong and Latrobe Valley airsheds, rural regions and local pollution hotspots.**

*RESPONSE provided by Chairman, Victorian Environment Protection Authority*

*EPA agrees with the conclusion that it has made improvements to ensure that quality data are available. EPA is continuing to make improvements and agrees with the recommendation that it finalise and implement an asset management strategy. Plans are already in place for the current business cycle to replace, acquire and fund equipment to meet current and emerging monitoring needs for the Melbourne-Geelong and Latrobe Valley airsheds, rural regions and local pollution hotspots. EPA will continue to assess and plan for Victoria's air quality monitoring needs and implement strategies to address those needs, in particular in accordance with national environment protection measures and state environment protection policies.*

### 3.2.5 Maximising the benefits of air quality management activities

In assessing whether the EPA has implemented our recommendations to maximise the benefits of its air quality management activities, we examined the EPA's progress in:

- establishing formal working arrangements with other agencies to coordinate activities
- developing a marketing strategy
- evaluating the effectiveness of the major activities it undertakes to improve air quality and the appropriateness of the mix of policy tools it uses to meet its responsibilities
- improving its reporting of air quality issues and the progress of its air quality management activities.

#### Formalised working arrangements with other agencies

State environment protection policy and air quality plans require the EPA to work with other agencies to improve air quality (such as agencies involved with public health, transport, planning and urban environmental management). Our 2002 report recommended that the EPA develop memoranda of understanding with its main government agency contacts, to formalise working arrangements with them.

The EPA's strategic plan recognises this need, placing a high priority on strengthening both formal and informal relationships with other agencies. Other than with the Essential Services Commission, we could not see any evidence of memoranda of understanding, or other formal arrangements, made since our 2002 report. The EPA continues to rely on good personal relationships to coordinate activities with several key agencies, including the Department of Human Services and the Department of Sustainability and Environment.

#### Marketing strategy

The EPA is responsible for informing the public about the consequences of poor air quality, and raising awareness about how Victorians can reduce air pollution.

In 2002, we reported that the EPA was drafting a marketing strategy to improve its communications with industry and the community, as recommended by its 1998 communications review.

It has since decided not to proceed with a marketing strategy. Decisions about communications activities and budgets are made as part of the annual budget process, and one business unit is responsible for marketing products and messages.

## Evaluating program effectiveness

The EPA measures its success in managing air quality by assessing air quality data annually against the 10-year goal and objectives for ambient air quality set out in state environment protection policy. The EPA reviews the effectiveness of the mix of policy tools it uses to manage air quality when it revises current policy and regulations.

The EPA has not formally evaluated the effectiveness of individual programs and activities it undertakes to improve air quality (such as activities to reduce motor vehicle emissions, or emissions from small-to-medium enterprises).

## Air quality reporting

The EPA produces a number of publicly available reports, which demonstrate that it is implementing aspects of its responsibilities under the State environment protection policy (Air Quality Management) attainment program.

The EPA has not completed the draft plan for implementing the attainment program it was developing at the time of our audit in 2002. Nor has it consolidated its internal priorities, milestones or budgets, to be able to monitor and report progress in implementing that program.

The EPA's 2002-03 annual report shows improved reporting of the environmental, social and economic impacts of its work. The report identifies the EPA's important initiatives and activities for the year. However, it does not link these initiatives and activities to the EPA's success or otherwise in achieving corporate objectives or targets, or direct readers to other sources for this information.

The EPA has posted reports about the way air quality affects Victoria's environment and community on its website. These include several recent reports into health and pollution issues in Melbourne and rural Victoria.

The EPA has reduced the time taken to release its annual air quality monitoring reports from 9 months to 6 months.

## Conclusion

The EPA has made progress in adopting the recommendations of our 2002 report for improving its air quality management practices, particularly in relation to improved reporting practices. However, it does not use an internal monitoring or reporting process to ensure that the attainment program of the State environment protection policy (Air Quality Management) is implemented within the 10-year life of the policy.

The EPA has not established formal arrangements with key agencies with which it works. Formal arrangements are important to ensure that the EPA is providing input to decisions and policies that have the potential to impact on the environment and sustainability in Victoria.

The EPA has decided not to proceed with a marketing strategy. Because of the limited resources available to the EPA, and the need to manage those resources wisely, we believe it is important that it develop a communications strategy, which includes a marketing strategy, to ensure the best mix of methods is used to maximise the impact of its communications activities.

The EPA has not formally evaluated the effectiveness of its major air quality activities. Such evaluations would help it to decide which activities and policies have the greatest impact and are the best value-for-money, and which are not worth pursuing. It needs this information if it is to continue to improve air quality through innovation.

# Recommendation

**53. That the EPA:**

- **establish formal arrangements with government agencies in areas of mutual responsibility**
- **develop and implement a communications strategy**
- **evaluate the effectiveness of its major programs and activities for managing air quality**
- **monitor and report internally on its progress in implementing the State environment protection policy (Air Quality Management) attainment program.**

*RESPONSE provided by Chairman, Victorian Environment Protection Authority*

*EPA places a high priority on strengthening both formal and informal relationships with other agencies. Taking into account EPA's statutory role, where considered to be mutually beneficial and appropriate, EPA agrees that it should establish formal arrangements with government agencies.*

*EPA evaluates the effectiveness of previous communications activities and sets communications priorities as part of its annual planning process. EPA will continue to identify priority activities for air quality communications and will integrate communications priorities into its corporate planning processes to ensure good communications outcomes with available resources. This may be in the form of strategic approaches to identifying and managing communications and marketing priorities and activities but may not necessarily take the form of a separate document. EPA will ensure the best mix of methods is used to maximise the impact of EPA's communications activities.*

*EPA agrees that it is important to evaluate the effectiveness of its major programs and activities for managing air quality. The primary mechanism that EPA uses to evaluate the effectiveness of its air quality programs and activities is through its continuous monitoring and assessment of Victoria's air quality. The results of these monitoring and assessment activities are then used to evaluate and inform policy, program and priority setting, and will continue to do so. In addition, EPA undertakes formal evaluations of specific programs and activities as part of statutory review processes. For example, EPA undertakes regular reviews of subordinate legislation such as regulations for motor vehicle emissions and the State environment protection policy for air quality management. Evaluations are determined on a priority basis but may not necessarily be a review of each and every individual activity.*

### RESPONSE provided by Chairman, Victorian Environment Protection Authority - continued

*EPA agrees that it is important to monitor and report internally on its progress in implementing the State environment protection policy (Air Quality Management). As an aim of the State environment protection policy (Air Quality Management) is to ensure that the air quality objectives of the State environment protection policy (Ambient Air Quality) are met, the primary mechanism that EPA uses to assess progress in implementing the State environment protection policy (Air Quality Management) is through its continuous monitoring and assessment of Victoria's air quality. The results of these monitoring and assessment activities are then used to evaluate and inform policy, program and priority setting, and will continue to do so. In addition, as part of EPA's business planning process, EPA monitors and reports internally on progress in implementing specific activities initiated under the State environment protection policy (Air Quality Management).*

# 3.3   Managing offenders on community corrections orders – interim report

## 3.3.1  Audit conclusion

At any one time, around 8 000 offenders are being supervised by corrections officers, undertaking community work and attending educational or treatment programs.

The Department of Justice is presently undertaking a redevelopment of correctional services. Strengthening the management and rehabilitation of offenders who serve their sentences in the community is a key aspect of this reform program. This is vital in ensuring community safety and helping offenders break the cycle of re-offending.

The department has made significant progress in the redevelopment of community corrections. Key initiatives which will affect the way offenders are managed have not yet been completed.

Our 2003-04 annual plan included an audit to assess the efficiency and effectiveness of the department's management of community correction orders. In the circumstances, it is prudent to defer completion of this performance audit to allow time for the department's reform program to be fully implemented.

## 3.3.2  Background

Community Correctional Services (CCS) is a business unit of the Department of Justice. It supervises adult offenders who are ordered by the courts to serve their sentences in the community. CCS currently supervises about 8 000 offenders on 18 100 court orders. The orders have punitive (loss of leisure time) and rehabilitative (education and treatment) components, and aim to divert offenders from prison, and to reduce re-offending.

Offenders are required to comply with the conditions of their order. These include:

- doing unpaid community work
- attending education and rehabilitation programs
- undergoing drug and alcohol assessment, treatment and testing
- periodic reporting to a community corrections officer.

An offender may be returned to court for re-sentencing if they do not comply with the conditions of their order.

In 2000, the department received $42.3 million (as part of the Corrections Long Term Management Strategy) to fund a 4-year program of cultural and other change in CCS. A key aspect of this change is a focus on individual case management and rehabilitation of offenders (so as to reduce re-offending) and not just enforcing order compliance. The department expects that improved management of offenders will give the courts greater confidence in non-custodial sentences (that is, in community corrections) as a sentencing option.

A key target of the changes is the diverting of 350 offenders who previously may have received prison sentences but, since the reform of community corrections, have received non-custodial sentences.

## Purpose and scope of audit

Our 2003-04 annual plan included an audit to assess the efficiency and effectiveness of the department's management of community correction orders.

Preliminary planning to develop the audit objectives and scope involved:

- discussions with senior departmental staff and with stakeholders (including the judiciary, service providers, criminology specialists and the Adult Parole Board)
- review of documents relating to community corrections
- visits to the Shepparton, Sunshine and Ringwood Community Correctional Services offices.

We identified 3 areas of CCS' activities:

- **Services provided to the courts.** CCS advises the judiciary about appropriate sentences for offenders, and about available programs and services. If courts are to consider community correction orders as a sentencing option, they must be satisfied with the service provided.
- **Offender management.** CCS' primary goal is to ensure that offenders comply with court orders. To do so, they supervise offenders, ensure they go to rehabilitation and education programs, and undertake community work.
- **CCS' performance management.** The consequences of poor offender management are serious – increased re-offending, more prisoners and reduced community safety. Consequently, the department needs to have adequate monitoring and evaluation systems to measure the quality of its offender management activities.

In assessing the department's management of offenders on community correction orders, we expected there to be:

- sound operational practices to ensure the efficient and effective management of offenders, that is, to ensure offenders are adequately assessed, comply with the conditions of their orders, and have access to rehabilitation programs they need

- adequate performance, quality assurance and information systems to assess how effectively offenders are being managed.

## Timeliness of our planned audit

At the time of our preliminary planning, the department had, as a part of its redevelopment program:

- employed 110 new staff (such as psychologists, program coordinators, indigenous officers and additional corrections officers)

- trained staff in motivational interviewing

- introduced a cognitive skills program for offenders

- piloted housing, education and employment programs for offenders

- revised management practices (by developing a range of sanctions and approaches for offenders who breach the conditions of their orders, as opposed to those who re-offend.

Further, other planned initiatives for managing offenders had yet to be completed. They included:

- **New offender management practices.** This is to be completed in late 2004. A comprehensive program of staff training will then be delivered in the 40 CCS offices. The practices aim to improve the ability of staff to help offenders successfully complete their orders.

- **New assessment tool.** This new tool will be used to assess offenders' needs and risk of re-offending, and will be introduced in October 2004. It will allow programs and services to be focused on offenders with the highest risk of re-offending.

- **Revised operating procedures.** Major reviews of community work, fine default order processing and court services are being finalised. It is expected that revised procedures will be issued to staff early in 2005.

- **New rehabilitation programs for violent offenders.** Delivery of these programs will start in early 2005.

- **Evaluation of Community Correctional Services' outcomes.** A consultant was recently engaged to evaluate the department's progress in meeting the diversion target of 350 offenders. Their report is due by November 2004.

## Conclusion

The department has made significant progress in the redevelopment of community corrections. Key initiatives which will affect the way offenders are managed have not yet been developed.

In the circumstances, it is prudent to defer completion of this performance audit to allow time for the department's reform program to be fully implemented.

### RESPONSE provided by the Secretary, Department of Justice

*The Department of Justice notes and concurs with this conclusion.*

AUDITOR GENERAL
VICTORIA

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