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Results of Audits

Purchase of contaminated land by the Melbourne Port Corporation

Raising and collection of fees and charges by departments

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Victorian Auditor-General's Office

Auditing in the Public Interest

The Hon. Robert Smith MLC
President
Legislative Council
Parliament House
Melbourne

The Hon. Jenny Lindell MP
Speaker
Legislative Assembly
Parliament House
Melbourne

Dear Presiding Officers

Under the provisions of section 16AB of the *Audit Act 1994*, I transmit my report on the *Results of Audits: Purchase of contaminated land by the Melbourne Port Corporation* and *Raising and collection of fees and charges by departments.*

Yours faithfully

DDR PEARSON
Auditor-General

19 June 2007

Foreword

This report presents the results of 2 recently completed audits which examined:

- the purchase of a contaminated site by the Melbourne Port Corporation, and its impact on the corporation's and its successor's (Port of Melbourne Corporation) finances
- the administration of fees and charges by government departments.

It finds that inadequate due diligence, non-compliance with government approval requirements and poor information available to decision-makers, contributed to the purchase of a contaminated site by the Melbourne Port Corporation at a price above its value, and exposed the corporation (and its successor entity) to substantial remediation costs.

The report also concludes that the departmental fees and charges subject to audit were based on appropriate legal authority and generally supported by adequate administrative systems and processes. Poor documentation, however, has meant that audit could not conclude whether certain rates charged were authorised in compliance with legislative requirements, and determined in accordance with government policy and guidelines.

The report identifies opportunities for improvement in each of the areas examined, and makes several recommendations to strengthen agency practices and performance.

DDR PEARSON
Auditor-General

20 June 2007

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1 Executive summary

1.1 Introduction

This report sets out the results of 2 audits which examine whether:

- Melbourne Port Corporation observed good practice and conformed with government approval requirements for the purchase of a contaminated site at Yarraville in 2001, at a price of $13.5 million
- government departments complied with the relevant legislative and policy requirements, and maintained adequate systems and processes, for the raising and collection of fees and charges.

The major conclusions and recommendations from these audits are presented below.

1.2 Overall conclusions

1.2.1 Purchase of contaminated land by the Melbourne Port Corporation

Potential future costs to remediate the purchased site are substantial and will have an adverse financial impact on the Port of Melbourne Corporation (PoMC) - the successor entity of the Melbourne Port Corporation (MPC).

At the date of audit, the net value of the site which was purchased for $13.5 million, was recorded by PoMC at $500 000. This outcome primarily resulted from MPC proceeding with the purchase of the property without sufficient knowledge of the environmental condition of the site. In particular:

- MPC did not undertake a rigorous assessment of the costs, benefits and risks associated with the proposed land acquisition
- there were shortcomings in the due diligence process, including a failure to observe the necessary transaction review and approval requirements, and to adequately brief the Treasurer and the MPC board on the uncertainties surrounding the condition of the property and the potential risks associated with the purchase.

Since the purchase, PoMC's policies and practices have been revised and internal procurement capability enhanced. Decisions to purchase land are now made with comprehensive information on the costs and benefits of the investment and the condition of a site.

1.2.2 Raising and collection of fees and charges by departments

Our examination of this activity covered 5 departments, including the former Department of Education and Training; Department of Infrastructure; Department of Justice; Department of Primary Industries; and Department of Sustainability and Environment. It also extended to the role of the Department of Treasury and Finance, as the responsible central agency, in relation to the administration of fees and charges.

Overall, we found that departments had appropriate legal authority to raise the fees and charges we examined, and generally maintained adequate systems and processes to support the administration of fees and charges. However:

- in relation to $6.6 million of user charges, we questioned whether the current rates levied by the relevant departments were appropriately "authorised" and valid. This is because the relevant departments could not provide the necessary documentation to demonstrate that they had complied with the required legal processes to "authorise" the current rates charged
- we could not conclude whether many of the fees and charges we examined were determined in accordance with government policy and guidelines, because information on how they had been set was not available.

We identified several areas where departments could improve their policies and internal controls over this activity, to minimise the risk of financial loss.

1.3 Major recommendations

Purchase of contaminated land by the Melbourne Port Corporation

1.1 That the responsible governing body and the Treasurer (where required) be fully informed of all relevant factors impacting on a purchase, including the key risks and costs associated with the transaction and any departures from government policy, when seeking approval for the purchase.

1.2 That agencies engaged to undertake due diligence reviews prepare a report outlining the results of their due diligence assessment, prior to completing the purchase.

1.3 That agencies ensure that they obtain a reliable estimate of the market value of the property proposed for purchase.

Raising and collection of fees and charges by departments

1.4 Departments should ensure that:

- all fees and charges they administer have been ”authorised” in accordance with the relevant legislative and/or regulatory requirements
- appropriate policies and procedures are established for the costing, setting and annual review of fees and charges
- management information systems used to administer fees and charges are subject to effective internal controls and adequately interface with primary financial systems.

1.5 The Department of Treasury and Finance should enhance the guidance it provides to departments and agencies on the setting and review of fees and charges, and the related financial compliance framework.

1.4 General

The audits included in this report were performed in accordance with Australian auditing standards. The total cost of the audits, including the preparation and printing of this report, was $440 000.

2 Purchase of contaminated land by the Melbourne Port Corporation

At a glance

Background

The Melbourne Port Corporation (MPC) was established in 1996 to manage, plan and coordinate development of the port. From 1 July 2003, the Port of Melbourne Corporation (PoMC) came into existence as the successor entity to MPC.

In August 2001, MPC purchased a contaminated industrial property in Yarraville for $13.5 million. The audit examined whether MPC had appropriate internal policies and procedures to evaluate property purchases and whether an adequate due diligence process was undertaken.

Key findings

- Potential future costs to remediate the purchased site will have an adverse financial impact on PoMC. Cost estimates for the site are substantial.
- MPC purchased the property without sufficient knowledge of the site's environmental condition. A rigorous assessment of the costs, benefits and risks associated with the proposed acquisition was not undertaken.
- MPC released the vendor from all responsibility for remediation of the site and exposed itself to significant future cost.
- Shortcomings in the due diligence process included a failure: to obtain the Government Land Monitor's approval; to comply with the Valuer-General's valuation; to brief the Treasurer and the MPC board adequately; and to assess the site's environmental condition prior to purchase.

At a glance - *continued*

Key recommendations

2.1 That the Department of Treasury and Finance, as the responsible central agency, ensure that agencies comply with its investment policies and guidelines.

2.2 That agencies comply with government policies and procedures when purchasing contaminated properties.

2.3 That agencies engaged to undertake due diligence reviews prepare a report outlining the results of their due diligence assessment prior to the agency completing the purchase.

2.4 That agencies ensure that they obtain a reliable estimate of the market value of the property proposed for purchase.

2.6 That all required approvals and authorisations be obtained prior to the purchase of a property.

2.7 That the responsible governing body and the Treasurer (where required) be fully informed of all relevant factors impacting on the purchase, including the key risks and costs associated with the transaction and any departures from government policy, when seeking approval for the purchase.

2.1 Overview

The Melbourne Port Corporation (MPC) was established in 1996 to manage, plan and coordinate development of the port. From 1 July 2003, the Port of Melbourne Corporation (PoMC) came into existence as the successor entity to MPC.

In August 2001, MPC purchased a 10-hectare industrial property in Yarraville for $13.5 million. Past use of the property for the manufacture and processing of acid, fertiliser and chemicals, and storage of agricultural chemicals, had contaminated the site.

Potential future costs to remediate the purchased site will have an adverse financial impact on the PoMC. Cost estimates for the remediation of the site are substantial. This outcome primarily resulted from MPC proceeding with the purchase of the property without sufficient knowledge of the environmental condition of the site. MPC did not undertake a rigorous assessment of the costs, benefits and risks associated with the proposed land acquisition. Other key audit findings included:

- MPC released the vendor from all responsibility for remediation of the site and in doing so, exposed itself to significant future costs.
- There were shortcomings in the due diligence process, namely:
  - the Department of Treasury and Finance (DTF) did not undertake a thorough assessment of the proposed purchase in accordance with government policy and guidelines
  - additional work recommended by DTF's environmental consultant, to determine the environmental condition of the property, was not undertaken
  - mandatory approval for the purchase from the Government Land Monitor (GLM) was not obtained
  - the Treasurer and the MPC board were not adequately advised of the uncertainties surrounding the condition of the property and the potential risks associated with the purchase
  - the Valuer-General (VG) was not provided with all relevant information necessary to provide an informed opinion on a reasonable price for the property
  - the site was purchased on terms and conditions that did not accord with the VG's valuation.

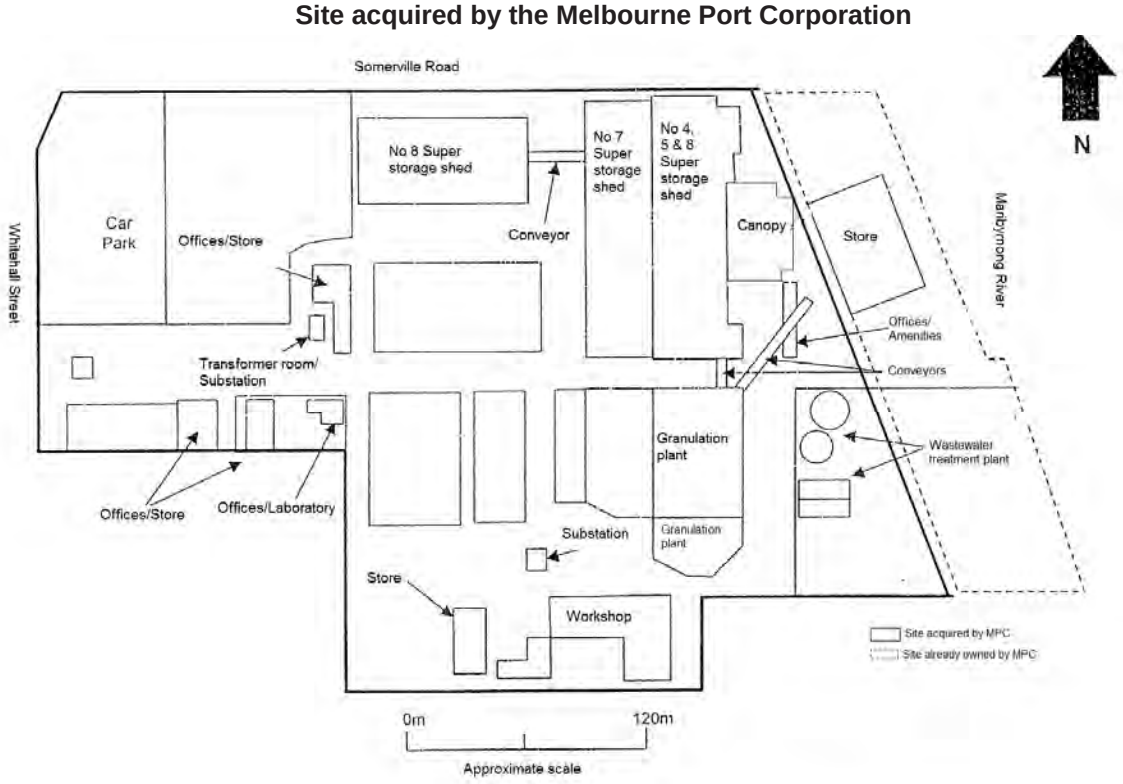
Since the purchase, PoMC's policies and practices have been revised and internal procurement capability enhanced. Decisions to purchase land are now made with comprehensive information on the costs and benefits of the investment and the condition of a site.

2.2 Introduction

In December 2000, MPC became aware that private industrial land in Yarraville might come onto the market. This was one of 3 privately-owned properties MPC had previously identified as "strategically important" for the future development of the port.

On 31 August 2001, MPC agreed to purchase the 10-hectare industrial property in Yarraville for $13.5 million. Figure 2A provides an overview of the property.

Figure 2A
Site acquired by the Melbourne Port Corporation



Source: Coffey Geosciences Pty Ltd, *Remedial Options Study*, 20 January 2005.

Environmental consultants had established that the use of the property, for the manufacture and processing of acid, fertiliser and chemicals, and the storage of agricultural chemicals since the early 1840s, had contaminated the site. The vendor had occupied the property since 1971.

At the date of purchase, the site was subject to an Environment Protection Authority (EPA) pollution abatement notice. The notice was issued on 18 May 1995 and required the occupier to assess the contaminated soil and ground water issues at the site. It also required an Environment Improvement Plan, including an investigation and works program, to be developed and implemented.

MPC owned the riverfront land (1.8 hectares in size) adjoining the site, which had been leased to the vendor over many years.

Following the purchase, the vendor continued to occupy the site for 2 years under a lease-back arrangement with MPC.

MPC intended to redevelop the site for future port purposes. However, due to the environmental issues affecting the site, it has yet to be developed.

Relevant government policies applicable to land purchases include:

- *Investment Evaluation Policy and Guidelines*, issued in September 1996 by DTF. The guidelines are designed to assist government departments and public bodies in evaluating capital investment proposals.
- *Policy and Instructions for the purchase, compulsory acquisition and sale of land*, (Policy and Instructions) issued in August 2000 by the Department of Sustainability and Environment (DSE)[1]. This policy provides government agencies and authorities with detailed guidance on the sale and purchase of contaminated land.

As a public body, MPC was required to comply with these guidelines.

2.2.1 Audit objective and scope

Following a referral from the Ombudsman's Office, an audit of the Yarraville property purchase was undertaken. The audit examined whether:

- MPC had established appropriate internal policies and procedures to evaluate property purchases
- an adequate due diligence process was undertaken and necessary authorisations and approvals obtained before the purchase of the Yarraville site.

2.3 Did MPC establish appropriate internal policies and procedures to manage the property purchase?

The *Investment Evaluation Policy and Guidelines* require government departments and public bodies to:

- develop investment evaluation policies and procedures that are consistent with the government's central policy framework, and prepare an investment proposal (business case) to support the purchase. The business case is required to outline how the investment proposal will:
  - address the agency and government's service priorities
  - benefit the economy (financial and socio-economic impacts)
  - impact on the agency's and state budget cash flows.
- submit their investment proposal to DTF for review and approval by the Treasurer (for investments exceeding $5 million).

[1] The Policy and Instructions were initially issued by the Department of Infrastructure. In late 2002, the function of GLM moved to the DSE and the policy document is now regarded as a DSE publication.

2.3.1 Investment policies and procedures

At the time the Yarraville property was acquired, MPC had not developed investment evaluation policies and procedures.

Preliminary work undertaken by MPC to develop its Port Land Use Plan[2] in 2001 identified a need over a 20-year horizon for land in the immediate vicinity of the port for port-related uses, and that land acquisition by MPC was "strategically important" for the future development of the port, given:

- MPC's holdings had been severely diminished with the establishment of the Docklands precinct
- waterfront land in the port area rarely becomes available
- the land presented an opportunity both to enhance the capability of existing shipping terminals and port infrastructure, and to protect the existing port from encroachment by non-port users
- the land created a buffer between Coode Island and residential land to the west.

In April 2001, the MPC engaged a consultant to examine development opportunities in relation to several privately-owned properties in Yarraville[3].

In a paper prepared for MPC's Investment Committee meeting in July 2001, several properties were identified for potential acquisition by MPC and details of MPC's initial discussions with the owners of these properties were provided. One of the properties identified, is the subject of this review.

While some of the benefits and costs of acquiring the property were identified in the above documents, MPC had decided to purchase the property without preparing a business case to support the purchase, as required by DTF's *Investment Evaluation Policy and Guidelines*.

The audit found that PoMC (the successor entity to MPC) has now:

- developed investment evaluation policies and procedures to manage its investments. These policies require preparation of a business case to support significant investments
- established a specialist unit to manage environmental issues impacting on the port.

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[2] Melbourne Port Corporation, *Port of Melbourne, Land Use Plan*, Melbourne, June 2002.

[3] Maunsell McIntyre Pty Ltd, *Yarraville Development Opportunities Review*, Melbourne, May 2001, pp. 7, 47.

2.3.2 DTF assessment of MPC's investment proposal

As the purchase exceeded $5 million, MPC was required to obtain the Treasurer's approval for the purchase. To obtain this approval, MPC needed to demonstrate that it met the criteria developed by DTF.

In discussions with MPC, DTF's Commercial Division raised a number of concerns with the Yarraville property purchase. These concerns were outlined in a DTF memo of 4 September 2001[4], specifically:

> "The briefing does not adequately explain MPC's intended use of the land. Submissions to the Treasurer for major capital expenditure proposals are normally supported by an investment evaluation consistent with the principles of DTF's Investment Evaluation Guidelines … the Treasurer has expressed some concern regarding MPC's declining return on capital employed over the planning period, which is significantly below its assessed weighted average cost of capital. One of the factors noted by the Treasurer is that MPC has significant land holdings that are not being utilised for port purposes, and these are detracting from MPC's capacity to achieve its cost of capital over the planning period. In this context, it would be helpful for MPC to detail its plans for the land and the Return on Investment/Net Present Value it expects from the property".

This indicates that critical information required to make an informed assessment on the merits of the proposal was outstanding, including:

- the planned use of the land
- the need to acquire the site at this time, given the significant land holdings that were not being utilised for port purposes
- demonstration that the expected return on MPC's investment was adequate.

Despite these comments, the Commercial Division did not specifically request MPC to prepare a business case and there was no evidence of any other evaluation by the Commercial Division of the MPC proposal.

On 6 September 2001, the Treasurer approved the purchase (refer to section 2.4.3 for further comment).

Conclusion

At the time of the property purchase, MPC had not established appropriate procedures and controls to ensure that investment decisions were soundly based and adequately supported.

A thorough assessment of the proposed purchase was not undertaken by DTF's Commercial Division in accordance with government policy and guidelines.

Consequently, this exposed the state to avoidable costs.

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[4] Manager Governance, Department of Treasury and Finance, 4 September 2001, MPC – Proposed Purchase of Land. Comments on Draft Ministerial Briefing of 29 August 2001.

Recommendation

2.1 That DTF, as the responsible central agency, ensures that:

- agencies comply with government policies and guidelines
- it assesses investment proposals in conformance with its own guidelines and instructions.

2.4 Was an adequate due diligence process undertaken prior to acquiring the site?

In June 2001, MPC engaged DTF's Victorian Government Property Group (DTF) to:

- negotiate the purchase of the site
- obtain the approvals and authorisations required
- undertake a due diligence assessment on behalf of MPC.

In reviewing DTF's due diligence process, the audit reviewed the management of environmental issues impacting on the site and whether required valuations and approvals were obtained.

2.4.1 Environmental issues

Currently, PoMC owns and manages over 500 hectares of land, much of which is contaminated as a result of its prior use.

The government's land policy[5] identifies the risks associated with the purchase of contaminated land. The policy indicates that agencies, in evaluating such purchases, need to minimise their potential exposure to legal liability for current and future site clean-up and other possible claims (i.e. personal injury, economic loss etc.).

Environmental risks associated with port land generally, and with the Yarraville site resulting from its past use and the significant levels of asbestos, particularly cement sheeting in the buildings on the site, were known to MPC prior to the purchase.

Advice provided to the MPC board in May 2001 from the consultants engaged by MPC to assess port-related development opportunities[6] indicated:

- "major clean-up costs" were a key constraint to purchasing the site
- the need for MPC to identify EPA requirements and clean-up costs, prior to entering into negotiations to purchase the property.

[5] Department of Sustainability and Environment, *Policy and Instructions for the purchase, compulsory acquisition and sale of land*, Victorian Government, Melbourne, August 2000.

[6] Maunsell McIntyre Pty Ltd, op cit.

Environmental reviews

During negotiations, DTF was provided with 2 initial environmental reports prepared for the vendor. Key findings of the June 2001 soil assessment included:

- soil on the site contained various metals (arsenic, copper and lead), sulphur, sulphate and phosphorus at concentrations below industrial health guidelines and, therefore, the site would be suitable for ongoing industrial use without soil remediation
- the need for an environmental management plan to prevent the contaminants impacting on the community and the surrounding environment.

Key findings of the August 2001 ground water assessment included:

- ground water has been adversely affected by both fertiliser manufacturing and the leaching of contaminants from historical fill on the site
- the most significant contaminants have been identified in the north-east and east portion of the site along the riverfront
- in view of the contaminant concentrations in ground water on the site and their expected mobility, there is some potential for environmental impacts to occur off-site to the south-west or to the river in the future
- there was no demonstrated adverse impact on the river arising from ground water emanating from the Yarraville site.

DTF also obtained independent environmental advice on the reports produced by the vendor's consultant. DTF's consultant:

- agreed that the conclusions reached by the vendor's consultant in relation to soil assessment were sound. However, he considered that the available data was insufficient and inadequate to enable an assessment of the impact of site contaminants on ground water and the river
- identified the need for further investigation of the site to disclose the source, extent and severity of contamination, and to provide a reliable estimate of remediation costs. The consultant indicated that the results of this investigation would potentially reveal the need for ongoing site monitoring or ground water remediation, which could continue for several years
- warned that EPA was likely to issue a clean-up notice for the site (given that a pollution abatement notice had already been issued on the site in 1995). If MPC was the owner/occupier of the site at the date of the notice, it would be responsible for clean-up costs. A portion of these costs could be recovered by MPC initiating a court action against the party/or parties it believed caused or contributed to the contamination.

Both consultants agreed that using the available data to estimate the cost of ground water remediation works would result in an estimate that "would be very rough and likely to be inaccurate" (facsimile from DTF's consultant to DTF, 13 August 2001).

As a result, DTF's consultant recommended that the responsibility for ground water management and remediation be quarantined from any contract of sale and that the liability and responsibility remain with the vendor. Further investigations of the environmental condition of the site, as recommended by the consultant, were not undertaken.

Despite these qualifications, DTF asked both consultants to provide an estimate of the ground water remediation costs. The remediation involved containing the contaminated ground water to prevent it from entering the river, treating the contaminated ground water and installing an ongoing monitoring network – considered a "reasonable worst case scenario". The consultants generally agreed on the work required, but differed in their assessments of how long the remediation would take.

The vendor's consultant estimated that the monitoring and remediation would continue for 2 years and cost between $210 000 and $450 000, while the government's consultant considered the monitoring and remediation was likely to take 10 years and cost between $450 000 and $1.05 million.

Due to the need for further assessment of the condition of the site and the uncertainty around the extent of remediation works required, MPC's position (throughout the negotiation process) was that the vendor should be responsible for all costs associated with environmental issues.

In mid-August 2001, following a breakdown in negotiations, the vendor offered the property for sale by public tender. The request for tender required the purchaser to:

- release the vendor from any damage that the purchaser may suffer in relation to the contamination (regardless of who caused it)
- indemnify the vendor for any harm arising in relation to the contamination as from the day of sale.

MPC submitted a tender for the property, but the tender stated that MPC would not accept the abovementioned conditions.

MPC was advised by the vendor that, although it had failed to meet the vendor's price expectations, it was the preferred tenderer and further negotiations with MPC would occur. The vendor required, among other things, that MPC "accept the site as is", with the vendors contributing $180 000 towards the remediation costs.

MPC indicated that it may accept this position if the sale was deferred for 3 weeks to facilitate further environmental testing or the vendor's contribution was increased to $320 000. This position was rejected by the vendor, and MPC was told that if it did not accept the vendor's conditions by 31 August 2001, the property would be offered to another party.

The MPC board was briefed on 31 August 2001 and agreed to purchase the property on the vendor's terms and conditions.

The contract of sale (dated 28 September 2001) stated that MPC as purchaser "… accepts the land in its present conditions and state of repair …" and "... indemnifies the vendor … and forever releases the vendor, from and against … the existence of any contamination and asbestos".

Audit identified that both PoMC and DTF now have significant internal technical capability to guide staff in dealing with contaminated land.

In addition, PoMC has revised its policies dealing with the purchase of contaminated land. The policies now:

- acknowledge that environmental contamination (soil, ground water and asbestos) is a key risk in any industrial property and seek to minimise the risk exposure by compliance with robust due diligence procedures
- require detailed environmental site assessments be undertaken to provide surety that the contamination status of the land is fully understood
- stipulate that the corporation will never provide indemnities to the vendor in respect of environmental and contamination issues.

EPA clean-up notice

In November 2003, following the vendor vacating the site, EPA issued MPC with a notice to clean-up the soil and ground water pollution on the site.

A further clean-up notice for the property was issued to PoMC in January 2007. The notice requires PoMC to annually monitor site contamination levels and report to the EPA, and sets in place specific milestones for:

- completion of an assessment of the extent of off-site ground water contamination caused by the contamination on the site (by 1 July 2007)
- commencement of remediation work to prevent off-site migration of polluted ground water into the river (by 30 November 2007).

Since the purchase, PoMC has engaged a number of consultants to provide estimates of the costs to remediate the site and time frames. Preliminary clean-up cost estimates for this site and adjoining riverfront land already owned by MPC range from $6 million to $70 million. Estimated costs for each parcel of land are not available.

Further work is currently being undertaken by PoMC to identify the most appropriate remediation solution or combination of solutions for the Yarraville site.

As the current estimate of remediation costs significantly exceeds those estimated at the time MPC acquired the site, PoMC sought legal advice on the options available to recover these additional costs. The preliminary advice dated March 2005 indicated:

- PoMC may have rights of claim against several parties
- further investigation and independent expert opinion was required to determine the potential success of any claim.

PoMC has advised that it is currently seeking further advice on the legal issues and its options.

At May 2007, MPC had incurred costs in excess of $500 000 in assessing the condition of the site.

In recognition of the estimated remediation and demolition costs associated with the Yarraville site, PoMC raised a provision of around $13 million in its 2005-06 financial statements. After taking into account the provision, the net value of the Yarraville site is $500 000.

Conclusion

In purchasing industrial properties, agencies need to be aware that the property may be contaminated and understand the implications this may have for the purchaser. If the property is contaminated, it is imperative that the purchaser be fully informed of all matters which may impact on the value of the property and the purchaser's financial exposure.

DTF had 2 roles in this transaction:

- as an agent for MPC, whose objective was to purchase the property
- to provide advice to MPC of any risks and issues associated with the purchase of the property following the outcome of its due diligence assessment.

These 2 roles, undertaken by DTF, are challenging and warrant particular attention to manage any potential for conflict.

While the uncertainty regarding the environmental condition of the property and the costs required to remediate the site were raised by the environmental consultants, the EPA and in valuation reports, there is no evidence that DTF recommended further assessment of the site or fully informed MPC of the risks associated with the purchase.

Recommendations

2.2 Agencies should comply with government policies and procedures. Specifically:

- agencies should have comprehensive knowledge of the condition of the site and any restrictions on its use
- where there are uncertainties regarding site condition or restrictions on use, additional work should be undertaken to identify the nature and extent of contamination prior to purchase
- costs associated with any remediation or other work required to make the site fit-for-use should be taken into account by agencies in determining a market value for the property
- any potential risks and costs to the agency, resulting from the purchase, should be identified and quantified.

2.3 Agencies engaged to undertake due diligence reviews should prepare a report, outlining the results of their due diligence assessment prior to the agency completing the purchase. This report should clearly identify any risks and issues arising from this assessment and whether government policy and due process, have been complied with.

2.4.2 Valuation of land

Under the government's land policy:

- 2 valuations must be obtained for land purchases where the value of the property is above $500 000
- where the sale terms and conditions are changed during the negotiation process, the valuers must be advised of these changes so that the impact on the valuations can be assessed
- land must not be purchased for an amount above the VG's valuation unless authorised by the VG and approved by the GLM.

In accordance with the government's land policy, the VG obtained 2 valuations. The valuers were instructed to value the site:

- in its current condition, with the cost of ground water management being the ongoing responsibility of the vendor
- subject to the vendor leasing back the site for 2 years
- on the assumptions that:
  - the costs of building demolition and removal are to be met by MPC
  - major items of plant and equipment are to be removed by the vendor.

DTF provided the VG and valuers with environmental assessment reports (commissioned by the vendor in 1992, 1995 and 2000), a briefing from the government's environmental consultant, correspondence from EPA, site plans, lease and licence agreements, and a March 2000 property valuation report for the site.

The March 2000 valuation of the property (obtained by the vendor), indicated that "in reality the subject property may not even be saleable, on an open market-vacant possession basis due to the potential soil and building contamination issues and the high costs and risks involved in a hypothetical redevelopment of the site" [7].

However, the following information, likely to impact on the value of the property was not conveyed to the VG:

- concerns expressed by DTF's appointed expert on the environmental reports prepared by the vendor's consultant
- the nature, extent and source of ground water contamination at the site had not been determined.

[7] 221 *Whitehall Street, Yarraville*, *Freehold and Leasehold Property Market Value and Market Value for the Existing Use*, March 2000, p. 9.

In addition, one quotation for the demolition of site buildings ($900 000 and valid for 60 days) was provided to the VG in July 2001. PoMC has recently estimated that it will cost around $6 million to demolish all buildings and pavements on the site[8].

Advice provided by the VG

The VG determined that the market value of the property was $11.5 million. The valuation was based on the cost of ground water management remaining the responsibility of the vendor.

However on 29 August 2001, DTF asked the VG to consider supporting a purchase price of $13.5 million. DTF provided the VG with information supporting the strategic significance of the site to MPC.

In a letter to DTF on 31 August (the day MPC made its offer for the property), the VG indicated that a premium of $2 million above market value could be justified based on the MPC receiving annual rental of $1 million. At that time, the vendor:

- was offering to rent the site for 2 years on an annual rental of $400 000
- indicated that it was unwilling to accept responsibility for site remediation, but offered to contribute $180 000 for ground water management.

The VG recommended that the government seek advice as to the adequacy of the $180 000 contribution from the vendor for ground water management and indicated that if it exceeded $250 000, the government should include the ability to seek further contributions from the vendor during their term of occupation.

The final sale terms and conditions accepted by MPC were:

- property purchase price $13.5 million
- annual rental of $400 000 over the 2-year lease-back period
- $180 000 contribution from the vendor for ground water management.

MPC's decision to accept the vendor's terms and conditions, which included releasing the vendor from all liability for remediation costs, accepting rental below the market rate and limiting the vendor's contribution for site restoration to $180 000, was not conveyed back to the VG for further assessment and comment, as required by the government's land policy.

[8] Tenders were called in March 2004 for demolition of around 10-15 per cent of all buildings on the site. The tender price was extrapolated to calculate the cost to demolish all buildings and pavements on the site.

Conclusion

Audit review of the valuation of the property identified that:

- the VG was not provided with all of the relevant information needed to provide an informed opinion on a reasonable price for the property
- the site was purchased on terms and conditions that did not accord with the VG's valuation
- sufficient work was not undertaken to determine an adequate estimate of demolition costs.

Recommendations

2.4 Agencies should ensure that they obtain a reliable estimate of the market value of the property proposed for purchase. This requires:

- all relevant information affecting the valuation of land, including any changes to the terms and conditions made during negotiations with the vendor, being provided to the VG to enable informed assessments to be made
- taking reasonable steps to confirm the accuracy of information provided to cost work required to be undertaken on the property, such as the demolition of buildings and improvements.

2.5 If agencies decide that they are willing to purchase a property at a price above its market value, they should obtain VG and GLM support for the purchase.

2.4.3 Approval for the purchase

GLM approval

The government's land policy requires land transactions of $250 000 or more to be approved by the GLM. The primary role of the GLM is to ensure that land transactions are legal, in the public interest and provide the best results for government.

In March 2001, MPC informed the GLM of its intention to negotiate the purchase of the Yarraville property.

The audit found:

- the GLM was involved throughout the negotiation period and attended meetings with DTF, valuers, MPC and the vendor, and also reviewed file documentation. However, the GLM was not invited to several key meetings where land value and the proposed terms and conditions of sale were discussed
- despite DTF advising MPC that it would obtain the GLM's approval for the purchase, this approval was not obtained. On 4 September 2001, DTF:
  - advised the GLM that the failure to obtain its approval prior to the purchase was due to an "oversight"
  - asked the GLM to provide a written approval for the land purchase dated prior to MPC's acceptance of the vendor's offer on 31 August 2001.

- the GLM formally advised DTF on 9 October that the GLM would not approve the purchase
- the GLM considered that "this matter has not been well negotiated" and that "an abnormal approach was taken"[9] due to:
  - the offer providing the vendor with a benefit of $15 million for the property which "was the price it [the vendor] always wanted".
  - the VG advice not supporting the final purchase price
  - the handling of the environmental issues
  - the VG not being instructed appropriately.

Treasurer's approval

MPC's offer for the Yarraville site was made subject to the Treasurer's approval being obtained in line with the government's requirements for capital purchases exceeding $5 million in value. This approval was obtained on 6 September 2001.

A written briefing to the Treasurer on the proposed purchase, prepared by DTF on 5 September 2001, did not raise a number of matters which were likely to impact on the Treasurer's decision to approve the purchase, including:

- instances where government policy and due process had not been complied with during the acquisition process:
  - a detailed investment proposal for the purchase had not been prepared
  - the final sale terms and conditions were not supported by the VG
  - GLM approval had not been obtained
- the potential costs and risks arising from the site's acquisition given:
  - the site was contaminated and subject to an EPA pollution abatement notice
  - a detailed environmental assessment to determine the nature, extent and source of ground water contamination was not undertaken and, therefore, potential liabilities were unknown
  - MPC had accepted the site in its present environmental state and released the vendor from any liability arising from the date of sale relating to the site's contamination.

Board approval

In the period June-August 2001, the MPC board was progressively briefed by management, at monthly meetings, on the status of negotiations with the vendor. The board endorsed the purchase of the property subject to:

- completion of a satisfactory due diligence process
- compliance with the VG's valuation and the GLM's approval
- the vendor retaining responsibility for remediation of the site.

[9] *Land Monitor Report*, Corner Whitehall Street and Somerville Road, Yarraville, 11 September 2001.

A written brief was provided by management to the MPC board on 31 August 2001 to gain its approval for the purchase of the property. The brief did not:

- adequately indicate the uncertainties around the condition and environmental issues affecting the site, and the risk to MPC in addressing these issues
- indicate that under the proposed contract of sale, MPC was to indemnify the vendor for any liability that may arise from contamination of the site from the day of sale (irrespective of who caused the pollution)
- include legal advice obtained by DTF, indicating that it was possible for the property to be compulsorily acquired.

Compulsory acquisition would have provided MPC with sufficient time to adequately investigate the environmental and other issues associated with the purchase.

The purchase (negotiation process) took around 3 months to complete.

Conclusion

Approval of the GLM for the purchase was not obtained, as required by government policy. Correspondence subsequently received by DTF from the GLM clearly indicates that it would not approve the purchase.

In approving the purchase of the property, the Treasurer and the MPC board were relying on the due diligence undertaken by DTF and briefings from their respective staff to ensure that all matters relevant to the purchase were brought to their attention.

The Treasurer and the MPC board were not fully advised of the uncertainties surrounding the property's environmental condition and the potential risks associated with the purchase.

Given the nature and extent of the environmental, valuation and other issues involved, and their potential impact on the MPC, the time allowed to investigate the risks associated with the purchase was insufficient.

Recommendations

2.6 All required approvals and authorisations should be obtained, prior to the purchase of a property.

2.7 The responsible governing body and the Treasurer (where required) should be fully informed of all relevant factors impacting on the purchase, including the key risks and costs associated with the transaction and any departures from government policy, when seeking approval for the purchase.

2.5 Financial impact of the purchase on MPC

The property was purchased for $13.5 million (net amount of $13.32 million after the vendor's contribution towards environmental costs). However, as outlined in Figure 2B, taking account of information known about the site at the time of purchase, audit estimated a fair market value for the property (including rental and licensing fees forgone as part of the purchase arrangements) was $10.1 million.

The audit calculation:

- does not take into account the strategic value of the site to MPC
- assumes the extent and cost of addressing the environmental issues were known at the time, however, this information was not known.

The difference between the net price paid by the MPC and the value of the site estimated by audit, is due to:

- MPC paying a premium of $2 million above the property's market value, in return for the vendor paying rental of $1 million per annum until the vendor vacated the site. The final agreement provided for rental of $800 000 over 2 years
- estimated costs to clean-up the site in excess of the $180 000 contributed by the vendor
- rental and licence fees forgone by the MPC on other land leased to the vendor (as part of the arrangements for the purchase of land).

Figure 2B
Financial impact of land purchase ($m)

Item	Property value estimated by audit
Market value of land determined by the Valuer-General *(a)*	**11.5**
Environmental clean-up costs	*(b)* (0.8)
Rental and licence fees forgone	*(c)* (0.6)
Sub-total	**(1.4)**
Total	**10.1**
Net amount paid	**13.32**
Net loss to MPC	**(3.22)**

(a) The valuation includes demolition costs, is based on the site being fit-for-purpose and assumes no environmental clean-up costs.

(b) Mid-point of the government's environmental consultant's cost estimate for monitoring and remediation.

(c) Rental and licence revenue forgone on other MPC properties.

Source: Victorian Auditor-General's Office.

The cost to remediate the Yarraville site has not been fully ascertained. Costs for the remediation of the site will be substantial.

Conclusion

MPC's purchase of the Yarraville property will result in significant assessment, remediation and demolition costs, far exceeding the costs contemplated at the date of purchase.

Any remediation of the purchased site will have an adverse financial impact on PoMC.

RESPONSE provided by the Chief Executive Officer, Port of Melbourne Corporation

The report recognises that the purchase of this land took place under the governance of the Melbourne Port Corporation. This predecessor organisation operated under a very different statutory regime and organisational arrangements than apply to PoMC. PoMC has substantially different policies and procedures for the purchase of property. A land acquisition policy which incorporates the key recommendations included in this report was approved by the PoMC board in June 2005 and is reviewed on a regular basis.

The term "contaminated land" is used throughout the report in a way which implies that contaminated land is unusual. In fact, almost all industrial land, particularly in the port environs, bears evidence of past use, some of which may not meet today's environmental standards; and can, therefore, be considered contaminated to some extent. Any acquisition of industrial land in the port precinct is likely to be an acquisition of "contaminated" land and the negotiated commercial arrangements will always involve allocation of responsibility for meeting environmental standards.

PoMC is committed to the resolution of the environmental issues affecting this particular property and has been actively engaged in working with the EPA and other industrial land holders in the area to agree upon a clean-up strategy. The environmental issues presented are the result of over 100 years of industrial usage and their identification and resolution is complex.

PoMC's draft Port Development Plan (PDP) sets out the port's vision of its development over the next 25 years. The PDP recognises that sections of the Maribyrnong precinct are essential for future port expansion. Even though the MPC was subject to different statutory objectives, its policy of acquiring land for port use and for buffering is noted as being consistent with the PDP.

RESPONSE provided by the Secretary, Department of Treasury and Finance

Two significant issues highlighted in the report regarding the acquisition are whether MPC undertook significant risk analysis and whether it received sufficient information to make a commercial decision.

While a Capital Investment Proposal was not received by DTF at the time of the acquisition, there is no reason to believe that the Government's Investment and Evaluation Guidelines were not considered by MPC. The investment imperative appears to have been strategic. DTF agrees that identifying and costing potential liabilities should be given significant emphasis when acquiring potentially contaminated land.

DTF acted as an agent for MPC in acquiring the property. Noting the tight time frames set by the vendor, DTF considers that all reasonable investigations were undertaken to enable MPC to make an informed decision as to whether the land should be acquired and on what terms.

With respect to section 2.5, DTF considers that the premium of $2 million assessed by the Valuer-General Victoria, did not only reflect the vendor paying an annual rental, but also the strategic importance of the site to MPC.

RESPONSE provided by the Secretary, Department of Sustainability and Environment

The views of both the Valuer-General and the Government Land Monitor have been accurately reflected in the report.

3 Raising and collection of fees and charges by departments

At a glance

Background

Government departments raise more than $600 million annually from fees and user charges.

We examined how well 5 departments managed the raising and collection of revenue from this source during 2005-06.

Key findings

Overall, we found that departments had appropriate legal authority to raise the fees and charges we examined, and generally maintained adequate systems and processes to support the administration of fees and charges.

However:

- in relation to $6.6 million of user charges, we questioned whether the current rates levied by the relevant departments were appropriately “authorised” and valid. This is because the relevant departments could not provide the necessary documentation to demonstrate that they had complied with the required legal processes to “authorise” the current rates charged
- we could not conclude on whether many of the fees and charges we examined were determined in accordance with government policy and guidelines, because information on how they had been set was not available.

We identified several areas where departments could improve their policies and internal controls over this activity to minimise the risk of financial loss.

Key recommendations

Departments should ensure that:

- all fees and charges they administer have been ”authorised” in accordance with the relevant legislative and/or regulatory requirements
- appropriate policies and procedures are established for the costing, setting and annual review of fees and charges
- management information systems used to administer fees and charges are subject to effective internal controls and adequately interface with primary financial systems.

In addition, the Department of Treasury and Finance should enhance the guidance it provides to departments and agencies on the setting and review of fees and charges, and the related financial compliance framework.

3.1 Overview

A wide range of regulatory fees and user charges are raised each year by government departments for services and products provided to the community, including individuals, businesses and government agencies. In 2005-06, departments raised around $640 million from this source.

Fees and charges underpin wide-ranging goods and services which have significant impacts on both businesses and citizens. Accordingly, these activities require sound administration and control.

We examined how well 5 departments managed the raising and collection of fees and charges during 2005-06. This involved assessing whether each had:

- complied with applicable legislative and policy requirements
- maintained adequate systems and processes to support this activity.

Audit conclusions

Overall, we found:

- the fees and charges examined to be based on appropriate legislative authority
- the systems and processes used to raise and collect fees and charges to be adequate to ensure that the revenues due to departments were duly recorded and collected.

However, we could not provide assurance that the current rates levied by the relevant departments to raise $6.6 million of the $404 million total fees and charges we examined, were appropriately "authorised" and valid[1]. This is because, in the case of 64 user charges, the relevant departments could not provide the necessary documentation to demonstrate that the required legal processes to "authorise" the current rates charged had been followed.

In many cases, information documenting how fees and charges had been set was not available. Accordingly, we could not conclude on whether they were determined in accordance with government policy and guidelines. Also, it was generally not evident that fees and charges had been subject to annual review, notwithstanding policy requirements and guidance to this effect. In these circumstances, departments risked both under and over-recovery of service costs.

[1] User charges are generally established under Acts of Parliament, but their value is approved/set by an "authorising process" involving either:

- an Order-in-Council
- their publication in the *Government Gazette*
- their publication in the *Government Gazette* after approval by the responsible minister.

Finally, we found scope for departments to improve their policies and internal controls over this activity to minimise the risk of financial loss. Areas requiring particular attention include the better interface/integration of supporting sub-systems with the primary departmental financial systems, and the establishment of improved documentation, access controls and backup procedures over the supporting systems.

Recommendations

Departments should ensure that:

- all fees and charges they administer have been ”authorised” in accordance with the relevant legislative and/or regulatory requirements
- appropriate policies and procedures are established for the costing, setting and annual review of fees and charges
- the management information systems used to administer fees and charges are subject to effective internal controls and adequately interface with primary financial systems.

The Department of Treasury and Finance, as the responsible central agency, should:

- enhance the guidance it provides to departments and agencies on the setting and review of fees and charges, to assist in the consistent and transparent application of government policy and expectations
- enhance the financial management compliance framework, established under the *Financial Management Act 1994*, to ensure that greater attention is given to compliance with each agencies’ and the government’s policies and other requirements, associated with the setting and administration of fees and charges
- in collaboration with “line” departments, investigate the viability of acquiring or developing common management information systems for use across departments, to facilitate the efficient and effective administration of fees and charges.

RESPONSE provided by the Secretary, Department of Education

I note in particular that fees and charges raised by the Department of Education amounted to $27 million. By far, the largest revenue line ($26 million) related to international fee-paying students, for which the department has established formal charges, based on legislative provision and authorised by Ministerial Orders, and has in place established control mechanisms over the receipt of fees.

RESPONSE provided by the Secretary, Department of Education - continued

The remainder of fees and charges by this department are subject to established budget management processes, which require reporting by all officers and senior management, consistent with the spirit of the Standing Directions of the Minister for Finance under the Financial Management Act 1994. These processes are also the subject of a bi-annual audit involving independent audit firms contracted through the internal audit branch of this department's Portfolio Improvement and Assurance Division.

The department, therefore, notes the report, and does not see the need to change business practices. The findings and recommendations, reflecting standard practice for the management and control of fees and charges will, however, be conveyed to business managers.

RESPONSE provided by the Secretary, Department of Justice

The Department of Justice has no concerns about the fairness and accuracy of the report and agrees with the intent of the recommendations to ensure that appropriate systems and processes are in place to support the administration of fees and charges.

However, it has been drawn to my attention that there are some significant resourcing implications associated with annually reviewing documentation of all charges levied, particularly for agencies such as Justice with a large number of revenue items. I, therefore, look forward to consultation with the Department of Treasury and Finance as the responsible agency on the implementation of your recommendations.

RESPONSE provided by the Secretary, Department of Primary Industries

This report has been reviewed and the Department of Primary Industries accepts the conclusions reached and agrees with the recommendations made. Further information has been sought from your officers to enable the department to effectively implement these recommendations and I am comfortable with the accuracy and fairness of the report.

RESPONSE provided by the Secretary, Department of Sustainability and Environment

I have noted the conclusions reached and recommendations noted in the report. I agree with the recommendations in so far as they relate to the Department of Sustainability and Environment. We will now commence implementing the recommendations which are specific to this department and will await advice from the Department of Treasury and Finance on whether any changes are necessary to our processes as a result of the implementation of recommendations applicable to them.

3.2 Introduction

A wide range of regulatory fees and user charges are raised each year by government departments for services and products provided to the community, including individuals, businesses and government agencies.

Regulatory fees are generally levied for rights of access, or specific actions granted via a permit or licence. They are designed to regulate activity and elicit a particular behaviour that produces some form of public benefit. As there is a public benefit component, these fees are often set below cost. Examples of these fees include recreational fishing licences and court fees.

User charges, on the other hand, are generally levied for the provision of goods or services that benefit and/or control the behaviour of specific user groups. As the benefits are derived by specific users, they are usually established on a full cost-recovery basis. Examples of user charges include the sale of publications, such as Victorian aerial maps, and accommodation hire at national parks.

In 2005-06, government departments raised around $640 million from fees and charges. Figure 3A shows the revenue raised from this source by each department.

Figure 3A
Fees and charges raised by departments, 2005-06

Department	($m)
Department of Justice *(a)*	283
Department of Sustainability and Environment	203
Department of Human Services	77
Department of Education and Training	27
Department of Primary Industries	18
Department of Treasury and Finance	14
Department for Victorian Communities	11
Department of Infrastructure	5
Department of Innovation, Industry and Regional Development	1
Department of Premier and Cabinet	1
Total	**640**

(a) Does not include Victoria Police, which raised fees and charges revenue totalling $28 million in 2005-06.

Source: Data sourced from the relevant department's annual reports and supporting information.

Fees and charges underpin wide-ranging goods and services which have significant impacts on both businesses and citizens. Accordingly, these activities require sound administration and control.

The government's policy and administrative framework relating to fees and charges is set out in:

- Standing Direction 3.4 - *Policies and Procedures* of the Minister for Finance under the *Financial Management* Act *1994*
- Budget and Financial Management Guide 21 (BFMG-21) *Guidelines for Setting Fees and User Charges Imposed by Departments and General Government Agencies,* issued annually by the Department of Treasury and Finance.

The minister's standing direction requires each department's chief financial and accounting officer (CFAO) to document, approve and (through a delegate) annually review the levels of charges levied by the department for goods and services it provides. The related guidance recommends that departments establish appropriate policies and procedures that, among other things, address how charges for goods and services are determined and approved, and how the associated revenue is processed and recorded within their information systems.

BFMG -21 provides guidance on how departments and other general government agencies should determine the appropriate level of fees and charges, and outlines the approval processes they must follow when implementing new, or increasing existing, fees and charges. The guidance also refers to the application of related legislation (such as the *Subordinate Legislation Act 1994* and the *Monetary Units Act 2004*) and the Government's Competitive Neutrality Policy, when establishing new, or increasing existing, fees and charges[2].

3.2.1 Audit objective and scope

We examined how well 5 departments, namely, the Department of Education and Training (DET); Department of Infrastructure (DoI); Department of Justice (DoJ); Department of Primary Industries(DPI); and Department of Sustainability and Environment (DSE) managed the raising and collection of fees and charges, over the period 1 July 2005 to 30 June 2006. This involved assessing whether each:

- had complied with the applicable legislative and policy requirements
- maintained adequate systems and processes to support this activity.

When assessing compliance with legislative and policy requirements, we examined whether the selected departments:

- had appropriate legal authority to raise the fees and charges they levied
- had established appropriate policies for the setting of fees and charges
- determined the level of fees and charges in accordance with government and internal policies

[2] The *Subordinate Legislation Act 1994* specifies additional approval processes, including when a Regulatory Impact Statement (RIS) may be required to be prepared, in relation to new or increased fees and charges. The *Monetary Units Act 2004* requires certain fees to be "unitised" and indexed annually. The Government's Competitive Neutrality Policy provides additional guidance to departments on pricing principles and processes. While advocating a full cost-recovery basis, it allows prices to be set above this level in certain circumstances.

- regularly reviewed the level of fees and charges
- reported on fees and charges consistent with policy requirements.

When assessing the adequacy of systems and processes in place, we examined whether:

- appropriate procedures were established to ensure the accurate and timely recording of all transactions
- the information systems used to record and manage fees and charges were efficient, and produced management information that facilitated the effective management of these revenues
- departments had adequate receivables and credit policies, and receivables were adequately managed
- departments had established appropriate processes to ensure that they complied with relevant policies and guidelines.

As departments had generally established multiple information systems to manage the many fees and charges they administered, to ensure an efficient audit process our attention was mainly directed to examining the more significant of these systems. However, we also conducted “high level” assessments of the smaller systems to identify any significant issues that may require attention.

In addition to our examination of the 5 departments, we examined the role of the Department of Treasury and Finance (DTF), as the responsible central agency, in relation to the administration of fees and charges.

Audit approach

The audit was undertaken in 2 stages.

The first involved a review and preliminary assessment of the central policy and procedural requirements, and the gathering of relevant information to inform our audit approach and the selection of departments to be subject to audit. This led to the selection of the 5 departments which, collectively, account for around 83 per cent of fees and charges raised across all departments.

A questionnaire was then issued to these departments to gather detailed information on the types and amount of fees and charges raised, the legislative and procedural arrangements in place, and the key information systems used to record and manage these revenues.

The second phase of the audit involved the assessment of questionnaire responses and the detailed examination of available documentation at each of the selected departments supporting the raising and administration of fees and charges.

Our examination included 1 083 fees and charges, which accounted for more than $404 million, or 63 per cent, of the revenues raised from this source.

3.3 Did departments comply with relevant legislative and policy requirements?

In assessing whether departments complied with the applicable legislative and policy requirements for the fees and charges raised, we examined if they had:

- appropriate legal authority to raise the fees and charges they managed
- established appropriate policies for the setting of fees and charges
- determined the level of fees and charges in accordance with government and internal policies
- regularly reviewed the basis for setting, and level of, fees and charges
- reported on fees and charges, in accordance with legislative and policy requirements.

3.3.1 Was there appropriate legal authority for the fees and charges raised?

For a department to levy and collect any fee or charge, it must have the legal authority to do so. This authority provides the support, in law, for the charges levied on the community, and often sets out the purposes to which the related revenue may be put by departments.

Regulatory fees are established, and their values set, either under the authority of Acts of Parliament or supporting regulations. The *Monetary Units Act 2004* may require fees to be expressed as monetary units, which must then be indexed annually using an inflation rate determined by the Treasurer.

User charges are also generally established under Acts of parliament, but their value is approved/set by an "authorising process" involving either:

- an Order-in-Council
- their publication in the *Government Gazette*
- their publication in the *Government Gazette* after approval by the responsible minister.

We examined 944 regulatory fees across the 5 departments and found them, in all cases, to be based on appropriate legal authority, and set consistent with the related legislative and/or regulatory requirements.

We also examined 139 user charges and found them to be based on appropriate legal authority. In 75 of these cases, we were also satisfied that the charge rates/levels were established in accordance with the required "authorising process" set out in the enabling legislation.

However, in 64 cases involving annual revenues of around $6.6 million, the relevant 4 departments could not provide the appropriate documentation containing authorisation of the user charges levied. In these cases, the departments advised that they were unable to locate the requested documents. Accordingly, we could not provide assurance that the amounts raised from these user charges were authorised.

The failure to appropriately authorise user charges levied by departments, consistent with applicable legal requirements, poses a significant risk to government of legal challenge questioning the validity of amounts collected from these sources. Aside from the potential for incurring significant legal and administrative costs, it can also undermine public confidence in departmental administration.

Recommendation

3.1 That departments ensure, as a matter of priority, that:

- all user charges they administer are appropriately authorised, in accordance with their enabling legislation or regulations
- they maintain appropriate documentation evidencing the authorisation of all fees and charges they manage.

3.3.2 Were appropriate policies established for the setting of fees and charges?

A large number of fees and charges are raised each year by departments and other public sector agencies. Consequently, a comprehensive whole-of-government policy framework is important for ensuring that the related goods and services are appropriately priced, and that fee-setting decisions are consistent with legislative requirements and government expectations.

It is also important that departments and other agencies develop their own policies, which expand on/customise the central policy framework, to ensure that their fee-setting practices comply with both the Government's and management's own expectations and requirements. This also helps improve internal and external accountability for fee-setting decisions.

The standing directions of the Minister for Finance require departments to document, approve and annually review the levels of fees and charges they administer. The *Guidelines for Setting Fees and User Charges Imposed by Departments and General Government Agencies* set out further government requirements and guidance on the setting of fees and charges, including requirements associated with the annual indexation of regulatory fees and the approval of new or increased fees and charges. They also describe the costing and pricing models that may be used by agencies when setting fees and charges. The guidelines are reviewed and updated annually by DTF.

While the ministerial standing directions and guidelines adequately set out the principles and requirements for departments and other agencies for setting fees and charges, there is scope to enhance the practical guidance included therein:

- *Annual review for fees and charges* – by outlining the steps and criteria to be applied by agencies each year (including documentation thereof) when assessing the appropriateness of each fee and charge.
- *Setting of fees and charges* – by including a "better practice" check list consolidating (and requiring documentation of) the key steps to be followed, and the key considerations to underpin, the setting and approval of individual fees and charges. The check list should be referenced to the relevant policy requirements and guidance, to assist in ensuring agency compliance.
- *Application of "user pays" principle* – by developing more specific guidance on the circumstances where under- or over-recovery of fees may apply, and where fees may constitute a tax – such as excessive over-recovery of costs.

Our review of the policies and procedures of the 5 departments subject to this audit revealed that the DoI and DET had not developed internal policies on the setting of fees and charges and, therefore, did not comply with the standing directions of the Minister for Finance. In addition, where departments had established internal policies, they were often not followed, particularly in relation to the setting and review of fees and charges.

Recommendations

3.2 That DTF implement our suggested enhancements to its guidelines, as part of its next guideline update process.

3.3 That departments ensure that:

- they have appropriate policies for the approval, setting and annual review of all fees and charges they administer
- staff involved in the administration of fees and charges are aware of, and are adequately trained in, the application of the departmental and government policy/guidance relating to fees and charges.

3.3.3 Were fees and charges determined in accordance with government policy and guidance?

The government's policy and guidance provide that fees and charges should reasonably reflect the cost of service provision, unless there is some overriding economic, social or environmental policy objective. Where government services compete with the private sector, fees and charges may also need to be adjusted to ensure "competitive neutrality" with the private sector, by eliminating any advantage afforded to government as the provider. Application of these principles means that user charges are generally set to fully recover costs, while regulatory fees may be set at or below cost, to meet policy objectives.

Notwithstanding the pricing method adopted, fees and charges are required to be annually reviewed, therefore, the costing and pricing methodologies should be documented and transparent.

None of the departments we examined had established processes to determine costs associated with fees and charges they administered. Consequently, in many cases, documentation on how specific fees and charges had been set was not available.

In the absence of appropriate documentation, we could not provide assurance that all fees and charges had been determined in accordance with government policy and guidelines. This is a particular concern for user charges which are generally required to be set on a full cost-recovery basis. Where input costs change, charges levied can become unrelated to the costs of service provision over time.

Problems can also arise in relation to regulatory fees that are subject to annual indexation. The original relationship between cost and pricing may be diluted over time through the application of annual indexation.

Under the financial management compliance framework, established under the *Financial Management Act 1994* and administered by DTF, departments are annually required to self-assess their compliance with the requirements of the *Financial Management Act 1994* and the related ministerial standing directions, and to certify their compliance to DTF. However, these certifications do not explicitly refer to the specific standing direction requirements relating to the setting, approval and review of fees and charges.

Recommendations

3.4 That departments adequately document how individual fees and charges are priced and set, including the rationale and approval of any significant under- and over-recovery of costs.

3.5 That the Government's financial management compliance framework be enhanced to ensure that the annual certifications of compliance provided by departments specifically address the requirements of the standing directions of the Minister for Finance and the associated guidelines relating to the administration of fees and charges.

3.3.4 Were fees and charges regularly reviewed?

The standing directions of the Minister for Finance require departments to annually review user charges, while the related guidelines recommend the annual review of both fees and charges.

Notwithstanding the above requirements and guidance, it was not evident that many fees and charges we sampled had been reviewed annually. This appears to have been the case for many years. For many others, documentation was not available to confirm whether fees and charges had been reviewed, or the date of the last review. In the absence of this information, we could not conclude whether the required reviews had been conducted.

In addition, for pricing decisions to be informed, departmental costing systems must allow sufficient detail to be obtained to identify the costs involved in service provision. We found that departmental systems used in the administration of fees and charges could not readily produce the required costing information.

In the absence of adequate costing information and regular review of fee and charge levels, we could not provide assurance that fees and charges were set at levels consistent with the cost of service provision. Risks for departments, and the Government more generally, associated with these circumstances range from the under-recovery of costs, to the levying of user charges substantially above cost, which users may construe to be more in the nature of a “tax” rather than a “user charge”.

Recommendation

3.6 That departments annually review the levels of fees and charges in accordance with the ministerial standing directions and the related guidelines, to ensure that they remain current and appropriate.

3.3.5 Have fees and charges been appropriately reported?

Section 10 of the *Monetary Units Act 2004* requires the monetary amount of fees subject to indexation to be disclosed to the general public. In February 2006, the Treasurer wrote to all departments, requiring them to make this disclosure on their websites, to increase transparency in relation to such fees.

We found that regulatory fees were posted on the respective departments’ websites and were readily available for viewing by the general public. While we identified some minor errors and omissions, these were corrected when indexation adjustments were made as at 1 July 2006.

There is currently no specific requirement for departments to report on user charges levied, consistent with the requirement for regulatory fees. Consequently, departments had not established systematic processes for reporting user charges.

Recommendation

3.7 That departments publish information on their websites on the user charges they levy, consistent with the information published for regulatory fees, to enhance transparency in relation to these charges.

3.3.6 Conclusions – Departmental compliance with legislative and policy requirements

Fees and charges examined were based on appropriate legislative authority. However, in the case of 64 user charges involving annual revenues of around $6.6 million, the relevant departments could not provide the necessary documentation to demonstrate that the required legal processes to authorise the current rates charged had been followed. In these circumstances, we were unable to provide assurance that those user charges complied with legislation and were valid.

In many cases, documentation of how fees and charges had been set was not available at the departments. Accordingly, we could not provide assurance that they were determined in accordance with the principles and policies espoused by government. Also, fees and charges were generally not subject to annual review, notwithstanding policy requirements and guidance to this effect. In these circumstances, departments risked both under- and over-recovery of service costs.

There is an immediate need for departments to ensure that all fees and charges they administer have been "authorised" in accordance with the relevant legislative and/or regulatory requirements. There is also a need for departments to ensure that they have established appropriate policies and procedures for the costing, setting and annual review of fees and charges, to help ensure that they are effectively managed and comply with government policy and guidance.

Finally, there is an opportunity for DTF, as the responsible central agency, to enhance the guidance provided to agencies on the setting and review of fees and charges, to assist in the consistent and transparent application of government policy and expectations.

3.4 Were departmental systems and processes for the raising and collection of fees and charges adequate?

In assessing whether departments maintained adequate systems and processes to support the raising of fees and charges, we examined if:

- they had adequate procedures to ensure the accurate and timely recording of all transactions
- the systems used to record and manage fees and charges were efficient, and produced useful management information
- they had adequate receivable and credit policies, and receivables were adequately managed
- they had established appropriate processes to ensure that they complied with relevant policies and guidelines.

3.4.1 Were adequate procedures in place to ensure accurate and timely recording of all transactions?

Of fundamental importance to any revenue system are procedures to ensure that all transactions are captured and recorded quickly and correctly. The standing directions of the Minister for Finance require all public sector agencies to establish and maintain documented policies and procedures that set out requirements for the complete and accurate processing of authorised transactions.

Typical procedures associated with revenue and accounts receivable systems include those dealing with information management system controls, the segregation of incompatible duties and functions, controls over accountable documents, and the regular reconciliation of cash/bankings and accounts receivable balances.

We found that all departments subject to audit had adequate policies and procedures over the processing and recording of revenue and accounts receivable transactions.

All departments performed regular reconciliations of revenue and bankings, thereby helping ensure that all revenue collections were accounted for and banked.

Controls over departmental financial systems were also operating effectively. System access was generally controlled by senior officers, changes to master files could only be made by authorised staff and appropriate password controls had been established.

However, we found several issues requiring attention in the sub-systems used by departments for processing transactions relating to regulatory fees and user charges, before this information was updated to the primary financial systems. These sub-systems are numerous and varied, ranging from Excel spreadsheets to sophisticated systems. Processing issues noted included:

- At DPI, receipts with an aggregate value of approximately $1.3 million were not promptly banked, with delays of up to 2 weeks found. Action had since been taken by DPI to improve processes and banking arrangements.
- Some delays in the processing of revenue and depositing of cheques at DSE. Certain transactions were not recorded for over one month when staff members took leave. Audit estimated the value of these transactions to be around $50 000.
- Inconsistencies in the timing of recording revenue at several departments, with some recorded on an accruals basis and others only recorded once the cash was received.

These issues arose partly because the relevant fees and charges did not represent a significant element of some departments' operations and were, therefore, not subject to the same level of control and rigour applied to larger revenue streams.

Recommendations

3.8 That departments ensure that revenue recording policy and procedures for fees and charges are appropriate and consistent with other revenue sources.

3.9 That relief staff are trained and available to operate key systems in the case of absences, to ensure that processing and reporting of fees and charges remains accurate and timely.

3.4.2 Were the systems used to record and manage fees and charges efficient, and did they produce useful management information?

To assess whether the departmental information systems used to record and manage fees and charges were efficient, we considered whether they included the following features:

- single entry of authorised transactions
- internal edit and other entry checks to ensure transaction correctness and completeness
- automated interfaces to other relevant reporting modules or systems
- flexible reporting, allowing for both financial and exception reporting.

We also expected that they would provide information on a timely basis, allowing management to review, monitor and control activity.

All departments use Oracle Financials as their primary financial reporting system, including for the reporting of revenues and accounts receivable. In addition, most departments use support systems to manage and monitor particular fees and charges. Information from these systems is then used to either manually or automatically update Oracle Financials. For example, an Excel spreadsheet may be used as a database to ensure that all licensing requirements are met, to store information on the license holder, and to raise invoices and monitor payments. Financial information will then be manually entered into Oracle Financials via a journal entry.

We found Oracle Financials to be internally efficient for financial reporting purposes, with adequate controls and reporting functionality. However, we found that:

- most of the supporting systems used by departments to record and manage fees and charges did not interface directly with Oracle Financials, resulting in inefficiencies from the double-entry of transactions, and the increased likelihood of errors or omissions
- many of the supporting processes and systems were “informal”, with poor systems documentation and controls over access and standing data, and inadequate backup processes.

These deficiencies increase the risk for departments of revenue loss, and recording and reporting errors.

Recommendations

3.10 That departments ensure that their existing fees and charges support systems:

- are assessed to determine and confirm the need for their ongoing operation
- are adequately documented and subject to effective internal control
- efficiently interface with, and complement, their primary financial systems.

3.11 That DTF, in collaboration with “line” departments, investigate the viability of acquiring or developing common management information systems for use across departments, to facilitate the efficient and effective administration of fees and charges.

3.4.3 Did agencies have adequate credit and receivables policies, and were these followed?

Many of the fees and charges are paid by customers at the time of application or before services are provided, usually by way of cash, credit card or direct debit. Accordingly, they generally do not give rise to receivables and, therefore, do not create a collectability risk. However, payments for other significant fees and charges, such as property searches for corporate customers, are not received until a later date. Accordingly, if adequate receivables and credit policies are not in place, departments can become vulnerable to revenue loss.

The standing directions of the Minister for Finance require agencies to establish appropriate policies for the granting of credit and the follow-up of outstanding debtors, including the regular review of the credit worthiness of customers, the collectability of receivables, and the accounting treatment of bad and doubtful debts.

We found that all 5 departments we examined had adequate policies for accounts receivables and the granting of credit for significant revenue streams, and adequate methods of informing staff of these requirements.

Monthly debtors' listings were prepared and reviewed by all these departments. Reports produced in regional offices were also sent to head offices, at least monthly. Departments had adequate procedures for the follow-up and collection of unpaid amounts and the write-off of bad debts.

We did not identify any significant policy or procedural issues in this area.

3.4.4 Had departments established appropriate processes to ensure they complied with relevant policies and guidelines?

The standing directions of the Minister for Finance require departments to establish appropriate quality assurance mechanisms to monitor, review and assess compliance with their policies and procedures. Under the financial compliance framework established under the *Financial Management Act 1994*, all agencies subject to the Act (including all departments) must annually certify whether they have complied with the standing directions.

We found that, due to the low dollar value of transactions in some departments, fees and charges were not subject to the same review processes and controls as larger revenue streams. As a result, the policy, process and documentation deficiencies highlighted throughout this article have not been identified by the departments' internal quality assurance processes for remedial attention.

Recommendation

3.12 The compliance frameworks of individual departments and the financial management compliance framework administered by DTF, should be enhanced to ensure that annual certifications of compliance extend to the requirements of the standing directions of the Minister for Finance and the associated guidelines, as they relate to the administration of fees and charges.

3.4.5 Conclusions – Adequacy of departmental systems and processes

Overall, departmental systems and processes for the raising and collection of fees and charges were adequate to ensure that the revenues due to departments were duly recorded and collected.

However, there is scope for departments to improve their policies and internal controls over this activity to minimise the risk of financial loss. Areas requiring particular attention include the better interface/integration of supporting/sub-systems with the primary departmental financial systems, and the establishment of improved documentation, access controls and backup procedures over the supporting systems.

The departmental and government financial compliance frameworks can also be enhanced to ensure that greater attention is given to assessing compliance with approved policies and procedures in relation to the setting, raising and review of fees and charges.

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