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Report 449

Regional Development Australia Fund, Military Equipment Disposal and Tariff Concessions

Review of Auditor-General Reports Nos 1-23 (2014-15)

Joint Committee of Public Accounts and Audit

June 2015
Canberra

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Foreword

On 4 December 2014, the Joint Committee of Public Accounts and Audit (JCPAA) resolved to review Australian National Audit Office (ANAO) Report No. 9 (2014-15), *Design and Conduct of the Third and Fourth Funding Rounds of the Regional Development Australia Fund*. On 5 March 2015, the JCPAA resolved to review a further two ANAO reports: Report No. 19 (2014-15), *Management of the Disposal of Specialist Military Equipment*; and Report No. 20 (2014-15), *Administration of the Tariff Concession System*.

A key theme emerging from the Committee's review of these reports was encouraging better practice, both in terms of grants administration and implementation of audit recommendations.

Grants administration is an important activity involving a significant amount of public funds each year. The transparency and accountability of grant funding decisions have been matters of longstanding Parliamentary and public interest. The Committee was therefore interested in the ANAO's findings on the administration of the Regional Development Australia Fund, which involved a considerable outlay of public funds. The grants administration framework, through the *Public Governance, Performance and Accountability Act 2013* and the Commonwealth Grants Rules and Guidelines (CGRGs), promotes transparent, accountable and cost-effective grants administration. The key message for agencies is that grant approval processes which comply with the requirements under this framework are more likely to see the best applications selected for funding, as well as enabling effective administration of approved funding for the least effort and cost.

Agency implementation of audit recommendations, which often reflect the ANAO's experience of practices other departments have found to be beneficial, is another area of longstanding JCPAA interest. In its audits, the ANAO identifies areas where administrative improvements can be made and, in most cases, makes specific recommendations to assist agencies in improving their performance. Once an entity has agreed to implement an audit recommendation, timely

implementation is important. The Committee has made findings in this area with regard to all three audit reports.

ANAO Report No. 9, *Design and Conduct of the Third and Fourth Funding Rounds of the Regional Development Australia Fund (RDAF)*, found that there was not a clear trail through the assessment stages to demonstrate that the projects awarded funding were those with the greatest merit in terms of the published program guidelines. The ANAO also found that the then Department of Regional Australia, Local Government, Arts and Sport had not implemented recommendations from a previous audit of the first RDAF funding round and inadequate attention had been given to relevant aspects of the grants administration framework. A key message from the audit was that considerable work remains to be done to design and conduct regional grant programs in a way where funding is awarded, and can be seen to have been awarded, to those applications that demonstrate the greatest merit in terms of the published program guidelines.

The Committee made four recommendations: that the ANAO consider a future audit of implementation of audit recommendations by the Department of Infrastructure and Regional Development (DIRD); that the ANAO incorporate a new section on 'Regional grants administration' in the next update of its Better Practice Guide on *Implementing Better Practice Grants Administration*; that the Department of Finance, in consultation with the ANAO, update the CGRGs as necessary to reflect recent audit findings in this area; and that the ANAO consider a follow-up audit of the effectiveness of grants administration by DIRD and establishing a standing audit focus on regional grants administration.

ANAO Report No. 19, *Management of the Disposal of Specialist Military Equipment (SME)*, highlighted a number of issues, including: disposal of decommissioned warships; disposal of specialist military equipment in operational areas; financial delegations; conflicts of interest; and staff training and corporate knowledge. Despite this, the Committee was encouraged by the fact that it was the Department of Defence itself that requested this ANAO audit, having recognised that problems existed regarding disposal of SME. Defence provided an overview of the reforms the department had instituted to address the concerns raised in the ANAO report. The Committee commends the ANAO recommendation that Defence rationalise and simplify the framework of rules and guidelines for disposal of SME. The Committee also notes Defence's assurances that it is developing a consolidated, streamlined and simplified framework on Defence disposals.

The Committee made two recommendations: that the ANAO consider a follow-up audit of progress in Defence reforms concerning the disposal of SME, and that Defence develop comprehensive training and handover procedures for staff in the Australian Military Sales Office, the office that manages disposals.

ANAO Report No. 20, *Administration of the Tariff Concession System*, found that the mature administrative arrangements established by the Australian Customs and Border Protection Service (Customs) have generally provided a sound basis for the administration of the Tariff Concession System (TCS). However, the ANAO report made three recommendations designed to improve the administration of TCS. The Committee is encouraged that, at a time when Customs is undergoing significant organisational change, it has begun taking reasonable action to implement the ANAO recommendations. The Committee takes the view that the ANAO report findings and recommendations should inform Customs as it integrates with the Department of Immigration and Border Protection and the compliance function shifts to the Australian Border Force from 1 July 2015.

The Committee made two recommendations: that Customs report back to the JCPAA on its continued progress implementing the ANAO recommendations, and that the ANAO consider undertaking a future cross-agency audit of the administration of the TCS following finalisation of the current organisational restructuring.

I thank Committee members for their deliberation on these matters. I also thank agency representatives who appeared at public hearings for assisting the JCPAA in its important role of holding Commonwealth agencies to account for the efficiency and effectiveness with which they use public monies.

Dr Andrew Southcott MP
Chair

Committee Secretariat

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	Ms Sandra Kennedy
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Terms of reference

On 4 December 2014, the Joint Committee of Public Accounts and Audit (JCPAA) resolved to review the following audit report in detail:

- Audit Report No. 9 (2014-15) *Design and Conduct of the Third and Fourth Funding Rounds of the Regional Development Australia Fund*

On 5 March 2015, the JCPAA resolved to review the following audit reports in detail:

- Audit Report No. 19 (2014-15) *Management of the Disposal of Specialist Military Equipment*
- Audit Report No. 20 (2014-15) *Administration of the Tariff Concession System*
- Audit Report No. 23 (2014-15) *Administration of the Early Years Quality Fund¹*

1 The Committee is yet to report on ANAO Report No. 23.



List of abbreviations

AG	Auditor-General
AMSO	Australian Military Sales Office
ANAO	Australian National Audit Office
APS	Australian Public Service
CDF	Chief of the Defence Force
DIRD	Department of Infrastructure and Regional Development
DMO	Defence Materiel Organisation
DRALGAS	Department of Regional Australia, Local Government, Arts and Sport
FMA	Financial Management and Accountability
HMAS	Her Majesty's Australian Ship
JCPAA	Joint Committee of Public Accounts and Audit
MRAP	Mine-Resistant Ambush Protected
NRF	Not Recommended for Funding
RAAF	Royal Australian Air Force
RAN	Royal Australian Navy
RFF	Recommended for Funding
RDAF	Regional Development Australia Fund

SFF	Suitable for Funding
SME	Specialist Military Equipment
US	United States
WHS	Work Health and Safety



List of recommendations

2 Design and Conduct of Third and Fourth Funding Rounds of Regional Development Australia Fund

Recommendation 1

The Committee recommends that the Australian National Audit Office consider prioritising the Department of Infrastructure and Regional Development – or, as applicable, the department responsible for administering the regional portfolio – in its continuing series of audits of agencies’ implementation of performance audit recommendations.

Recommendation 2

The Committee recommends that in the next update of its Better Practice Guide, *Implementing Better Practice Grants Administration*, the Australian National Audit Office (ANAO) consider incorporating a new section on ‘Regional grants administration’, focusing on the findings of recent ANAO reports on this area and the Committee’s report, to maintain an emphasis on increased effectiveness in regional grants administration.

Recommendation 3

The Committee recommends that the Department of Finance (Finance), in consultation with the Australian National Audit Office (ANAO), update, as required, the Commonwealth Grants Rules and Guidelines to reflect recent ANAO audit findings concerning departmental grants administration, including further reinforcing the requirement for decision-makers to record the basis for funding decisions.

Recommendation 4

To encourage better practice grants administration, particularly concerning regional grants programs, the Committee recommends that the Australian National Audit Office (ANAO) consider including in its schedule of performance audits:

- priority follow-up audits of the effectiveness of grants program administration by the Department of Infrastructure and Regional Development
- a standing priority audit focus on regional grants administration by the relevant department (with the specific timing of such audits as determined by the ANAO), noting that a potential performance audit of the design and implementation of the National Stronger Regions Fund is included in the ANAO's current forward Audit Work Program

3 Disposal of Specialist Military Equipment

Recommendation 5

The Committee recommends that the Australian National Audit Office (ANAO) consider a follow up audit 12 months following the tabling of this report to provide an update on the progress of Department of Defence's reforms with regard to the disposal of Specialist Military Equipment. Further audits in this area could be considered by the ANAO.

Recommendation 6

The Committee recommends that the Department of Defence develop comprehensive training programs, instruction procedures and handover briefs for all new Australian Military Sales Office staff.

4 Administration of the Tariff Concession System

Recommendation 7

The Committee recommends that the Department of Immigration and Border Protection report back to the Joint Committee of Public Accounts and Audit, within six months of the tabling of this report, on its continued progress implementing the Australian National Audit Office (ANAO) recommendations in Report No. 20 (2014-15).

Recommendation 8

The Committee recommends that the Australian National Audit Office (ANAO) consider undertaking a cross-agency audit (Department of Industry and Science, and the Department of Immigration and Border Protection) of the Tariff Concession System at least 12 months following the finalisation of the Department of Immigration and Border Protection's organisational restructuring and the commencement of the Australian Border Force.

Introduction

Background to the review

- 1.1 The Joint Committee of Public Accounts and Audit (JCPAA) has a statutory duty to examine all reports of the Auditor-General presented to the Australian Parliament and report the results of its deliberations to both Houses of Parliament. In selecting audit reports for review, the Committee considers:
- the significance of the program or issues raised in audit reports
 - the significance of audit findings
 - the arguments advanced by the audited agencies
 - the public interest arising from the report
- 1.2 On 4 December 2014, the Committee selected the following Australian National Audit Office (ANAO) performance report for further review and scrutiny at public hearings:
- Audit Report No. 9 (2014-15) *Design and Conduct of the Third and Fourth Funding Rounds of the Regional Development Australia Fund*, Department of Infrastructure and Regional Development
- 1.3 On 5 March 2015, the Committee considered ANAO performance reports Nos 1-23 of 2014-15. The Committee selected a further three reports for review and scrutiny at public hearings:
- Audit Report No. 19 (2014-15) *Management of the Disposal of Specialist Military Equipment*, Department of Defence
 - Audit Report No. 20 (2014-15) *Administration of the Tariff Concession System*, Australian Customs and Border Protection Service

- Audit Report No. 23 (2014-15) *Administration of the Early Years Quality Fund*, Department of Education and Training, Department of Finance and Department of Prime Minister and Cabinet¹
- 1.4 Public hearings for the Report Nos 9, 19 and 20 were held on:
- 6 March 2015 (Audit Report No. 9)
 - 14 May 2015 (Audit Reports Nos 19 and 20)

The Committee's report

- 1.5 This report of the Committee's review of a number of ANAO reports draws attention to key issues raised in the original reports, as well as at public hearings and in agency submissions.² Where appropriate, the Committee has commented on unresolved or contentious issues, and made recommendations.
- 1.6 The report is structured as follows:
- Chapter 2: Audit Report No. 9 (2014-15) *Design and Conduct of the Third and Fourth Funding Rounds of the Regional Development Australia Fund*
 - Chapter 3: Audit Report No. 19 (2014-15) *Management of the Disposal of Specialist Military Equipment*
 - Chapter 4: Audit Report No. 20 (2014-15) *Administration of the Tariff Concession System*
- 1.7 The following appendices provide further information:
- Appendix A – List of submissions
 - Appendix B – List of public hearings and witnesses
- 1.8 Each chapter of this report can usefully be read in conjunction with the relevant ANAO report.

1 The Committee is yet to report on ANAO Report No. 23.

2 Note on references: references to the Committee *Hansard* for Audit Reports Nos 19 and 20 are to the proof *Hansard*. Page numbers may vary between the proof and official *Hansard* transcript.

Performance Audit Report No. 9 (2014-15)

Design and Conduct of Third and Fourth Funding Rounds of Regional Development Australia Fund

Introduction

- 2.1 Chapter 2 focuses on the Joint Committee of Public Accounts and Audit (JCPAA) review of Australian National Audit Office (ANAO) Report No. 9 (2014-15), *Design and Conduct of the Third and Fourth Funding Rounds of the Regional Development Australia Fund*, Department of Infrastructure and Regional Development. The chapter comprises:
- an overview of the report, including the audit objective, scope and criteria; audit conclusion; and audit recommendations and agency response
 - Committee review
 - Committee comment

Report overview

- 2.2 The Regional Development Australia Fund (RDAF) was established in early 2011 as a nationally competitive, merit-based grants program with discrete funding rounds. Four RDAF funding rounds were delivered between 2011 and 2013, with the third and fourth funding rounds being

conducted between October 2012 and June 2013.¹ Table 2.1 sets out the number of applications approved and funding over the four rounds.

Table 2.1 RDAF applications and funding over rounds one to four

Funding round	Date round opened	Applications approved	Funding approved
Round one	3 March 2011	35	\$149.7 million
Round two	3 November 2011	46	\$199.8 million
Round three	26 October 2012	79	\$31.1 million
Round four	26 October 2012	42	\$195.2 million
Total		202	\$575.8 million

Source ANAO, Audit Report No. 9 (2014-15), Table 1.1, p. 38

2.3 Administration of RDAF was initially allocated to the then Department of Regional Australia, Regional Development and Local Government, which became the Department of Regional Australia, Local Government, Arts and Sport (DRALGAS) in December 2011.² Since September 2013, following the change of government, RDAF has been administered by the Department of Infrastructure and Regional Development (DIRD).

2.4 The ANAO conducted a previous inquiry into the first RDAF funding round in September 2012.³

Audit objective, scope and criteria

2.5 The objective of the ANAO audit was to assess the effectiveness of the design and conduct of the third and fourth RDAF funding rounds. The scope of the audit included the processes by which proposals were sought and assessed, and successful projects were approved for funding.

2.6 To form a conclusion against the audit objective, the ANAO adopted the following high-level criteria:

- application and eligibility assessment processes promoted open, transparent and equitable access to the available funding;
- the merit assessment process identified and ranked in priority order those eligible applications that best represented value

1 ANAO, Audit Report No. 9 (2014-15), *Design and Conduct of the Third and Fourth Funding Rounds of the Regional Development Australia Fund*, DIRD, p. 14.

2 The ANAO report refers to DRALGAS as the department then responsible for the design and conduct of RDAF rounds three and four, and to DIRD as the department consulted by the ANAO for the purposes of the audit and now responsible for implementing the report recommendations. For further clarification of this matter, see ANAO, Audit Report No. 9 (2014-15), p. 11.

3 ANAO, Audit Report No. 3 (2012-13), *Design and Conduct of the First Application Round for the Regional Development Australia Fund*, DRALGAS.

with public money in the context of the program objectives and desired outcomes;

- the Minister, as decision-maker, was well briefed on the assessment of the merits of eligible grant applications, was provided with a clear funding recommendation and the reasons for the funding decisions were transparent (consistent with the requirements of the broader financial framework and the grants administration framework); and
- the distribution of funding in geographic and electorate terms was consistent with the program objectives and guidelines, and was consistent with funding being awarded on the basis of competitive merit.⁴

Audit conclusion

2.7 The ANAO's overall conclusion was as follows:

The assessment and selection process as it was described in the program guidelines reflected a sound approach. However, in the manner implemented, the stages were not well integrated in that each step informed the next in only a limited way. As a result, there was not a clear trail through the assessment stages to demonstrate that the projects awarded funding were those that had the greatest merit in terms of the published program guidelines ...

This shows that the recommendations made in the first audit, agreed by the department, had not been implemented by the department, and inadequate attention was given to relevant aspects of the grants administration framework. Effectively implementing agreed recommendations ... and closer adherence to identified principles of better practice grants administration are matters that warrant greater attention by the department ...

A further similarity between the third and fourth RDAF rounds and the first round was that a relatively high proportion of approved projects had not been recommended for approval by the panel ...

4 ANAO, Audit Report No. 9 (2014-15), pp. 44-45. References to the 'published program guidelines' are to the department's 'RDAF Guidelines' published for rounds one to four. References to the 'grants framework' are to the framework in place at the time the funding rounds were completed (this included the *Financial Management and Accountability Act 1997* and the Commonwealth Grant Guidelines). Similar arrangements exist under the new framework, with the *Public Governance, Performance and Accountability Act 2013* and the Commonwealth Grants Rules and Guidelines taking effect from 1 July 2014. References to 'selection criteria' are to the four selection criteria for RDAF rounds three and four, as set out in Table 3.2, Audit Report No. 9, p. 69.

the then Government's guidelines for this program provided for the advisory panel to make the recommendations to the Minister as to those applications that should be awarded funding. Further, the grants administration framework has been designed to accommodate situations where decision-makers do not accept the advice they receive. Amongst other things, it requires that the basis for funding decisions be recorded. However, the records of the reasons for funding decisions taken contrary to panel advice generally provided little insight as to their basis and made no reference to the published selection criteria. This situation was particularly significant given that such decisions were largely at the expense of projects located in electorates held by the Coalition.⁵

- 2.8 The ANAO further noted that, in the context of improving grants administration, 'the most important message from this audit is that considerable work remains to be done to design and conduct regional grant programs in a way where funding is awarded, and can be seen to have been awarded, to those applications that demonstrate the greatest merit in terms of the published program guidelines'.⁶

Audit recommendations and agency response

- 2.9 Table 2.2 sets out the recommendations for ANAO Report No. 9 and DIRD's response.⁷

Table 2.2 ANAO recommendations, Report No. 9 (2014-15)

1	<p>To improve the efficiency and effectiveness of any future two-stage grant application process, ANAO recommends that the Department of Infrastructure and Regional Development:</p> <ul style="list-style-type: none"> • include an assessment of eligibility considerations as part of the design of the expression of interest stage so as to minimise the risk of ineligible applications being received and allow the second assessment stage to focus on merit considerations; and • minimise duplication of effort, and provide a clear line of sight through the assessment process, by drawing upon the results of the assessment of expressions of interest where there are similarities or inter-relationships between some of the shortlisting criteria for expressions of interest and the assessment criteria for full applications. <p>DIRD's response: <i>Agree.</i></p>
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5 ANAO, Audit Report No. 9 (2014-15), pp. 14-19. The response of the then Minister for Regional Services, Local Communities and Territories to the ANAO report and the ANAO comment is at Appendix 2, pp. 164-166. The RDAF advisory panel's response to the ANAO report and the ANAO comment is at Appendix 3, pp. 167-181.

6 ANAO, Audit Report No. 9 (2014-15), p. 21.

7 For details of DIRD's response to the ANAO's recommendations, see ANAO, Audit Report No. 9 (2014-15), pp. 159-161.

2	<p>ANAO recommends that the Department of Infrastructure and Regional Development incorporate in the value with money methodology adopted in future granting activities an approach that reflects that applications assessed as not satisfactorily meeting the published merit assessment criteria are most unlikely to represent value with public money in terms of the objectives of the granting activity.</p> <p>DIRD's response: <i>Noted.</i></p>
3	<p>To improve the quality and clarity of advice provided to decision-makers, ANAO recommends that in future advice on the merits of proposed grants where funding is to be allocated using a competitive merit-based selection process, the Department of Infrastructure and Regional Development provide advice that:</p> <ul style="list-style-type: none"> • clearly and consistently establishes the comparative merit of applications relative to the program guidelines and merit criteria; and • includes a high level summary of the assessment results of each of the competing proposals in terms of their merit against the published criteria. <p>DIRD's response: <i>Agree.</i></p>

Committee review

- 2.10 Representatives from DIRD and the ANAO gave evidence at the Committee's public hearing on 6 March 2015.
- 2.11 As discussed below, the Committee focused on four matters regarding the ANAO report findings and evidence provided at the public hearing:
- Assessment and funding stages
 - Transparency and accountability
 - Implementation of ANAO report recommendations
 - Better practice regional grants administration

Assessment and funding stages

- 2.12 By way of background, the assessment phase for RDAF funding involved the following stages:
- assessment of expressions of interest (EOIs) by 55 Regional Development Australia (RDA) committees, with projects being ranked in order of priority by region
 - assessment of eligible applications by DRALGAS, with those assessed as representing value with money being ranked in order of merit against the selection criteria overall
 - assessment of eligible applications by an advisory panel of five members selected for their experience, knowledge and expertise on

regional Australia (panel membership remained the same across each of the four RDAF rounds)⁸

- 2.13 The advisory panel's advice was provided to the then Minister for Regional Services, Local Communities and Territories by DRALGAS.⁹ The results of the department's assessment of applications against the selection criteria were contained in 'assessment snapshots' and these were also provided to the Minister.¹⁰
- 2.14 As discussed below, the following matters were of interest concerning the RDAF assessment and funding stages: alignment of departmental and advisory panel assessment stages; the department's assessment of applications; the advisory panel's assessment of applications; and the Minister's funding decisions.

Alignment of departmental and advisory panel assessment stages

- 2.15 The ANAO report noted that, similar to the first RDAF round and notwithstanding the department having agreed to a recommendation concerning this matter from the previous ANAO report, assessment of individual eligible applications against the published criteria, as recorded by the department and provided to the Minister for RDAF rounds three and four, did not align with the advisory panel's categorisation of applications.¹¹
- 2.16 While the assessment and selection process, as described in the RDAF program guidelines, reflected a 'sound approach', the ANAO report therefore observed that in the manner implemented the stages were 'not well integrated in that each step informed the next in only a limited way'.¹² As the Auditor-General further commented:

A key conclusion of the audit was that there was not a clear trail through the various assessment stages adopted in rounds three and four to demonstrate that the projects recommended for funding, and those ultimately awarded funding, had the greatest merit in terms of the published selection criteria. In particular, the order of regional priority allocated to projects by the RDA committees was not used to inform the assessment of applications, and there was not a clear and consistent alignment between the

8 ANAO, Audit Report No. 9 (2014-15), p. 103.

9 ANAO, Audit Report No. 9 (2014-15), p. 12.

10 ANAO, Audit Report No. 9 (2014-15), p. 110. Further explanation of this process was provided by Mr Gordon McCormick, General Manager, Regional Programs Branch, DIRD, *Committee Hansard*, Canberra, 6 March 2015, p. 3.

11 ANAO, Audit Report No. 9 (2014-15), p. 26.

12 ANAO, Audit Report No. 9 (2014-15), p. 14.

RDAF Advisory Panel's funding recommendations and the results of the department's assessment of each application against each of the published selection criteria.¹³

Department's assessment of applications

2.17 The ANAO report observed that 'improvements in the quality of the department's assessment work were evident in the first RDAF round audited by ANAO' and this trend 'continued in the third and fourth funding rounds', particularly in relation to eligibility checking and conduct of risk assessments.¹⁴ However, the ANAO noted 'significant shortcomings in the methodology' used by the department to assess the merit of competing applications in terms of the published selection criteria and that the department had not fully implemented previous ANAO report recommendations concerning the first RDAF funding round 'designed to address these shortcomings'.¹⁵ As the ANAO commented, 'instead of fully implementing these recommendations', the department retained:

- the same qualitative rating scale it had used in the first funding round, notwithstanding that it 'does not provide a clear and consistent basis for effectively discriminating between the relative merits of competing applications'
- an 'unsound methodology' for assessing value with public money, whereby applications assessed as not satisfactorily meeting up to three of the four selection criteria were identified as representing value with money¹⁶

Advisory panel's assessment of applications

2.18 The RDAF advisory panel was tasked with considering the individual and relative merits of 192 eligible applications in round three, and 159 eligible applications in round four, and with recommending the most meritorious to the Minister.¹⁷ As required by the program guidelines, the advisory panel classified each eligible application into one of three categories:

- Recommended for Funding (RFF)

13 Mr McPhee, Auditor-General, ANAO, 'Opening statement', *Submission 2*, p. 2.

14 ANAO, Audit Report No. 9 (2014-15), p. 22.

15 ANAO, Audit Report No. 9 (2014-15), p. 22. (See ANAO recommendations 1-3, Audit Report No. 3 (2012-13), pp. 28-29.) Implementation of the ANAO report recommendations and DIRD's comments on this matter are further discussed in a later section.

16 ANAO, Audit Report No. 9 (2014-15), p. 22. As the ANAO noted, 'applications that do not satisfactorily meet each of the published selection criteria are most unlikely to represent value with public money in terms of the objectives of the granting activity', p. 22.

17 ANAO, Audit Report No. 9 (2014-15), pp. 22-23.

- Suitable for Funding (SFF)
- Not Recommended for Funding (NRF)¹⁸

2.19 The ANAO report found that, while the advisory panel viewed those projects it recommended as being of the highest quality, the approach the panel adopted to determining its recommendations was 'not consistent with a transparent, competitive, merit-based process to awarding grant funding in accordance with an assessment of applications against the published criteria'.¹⁹ As the ANAO further explained, notwithstanding the recommendations of the previous ANAO report on the first RDAF round, 'the methodology the panel had developed in August 2011 on the first day of its deliberations for the first funding round continued to be applied in May 2013 for rounds three and four'.²⁰ As a result, and notwithstanding that the program guidelines required the advisory panel to assess and rank eligible applications based on the published selection criteria, there were 'no documented panel assessments of each application in relation to those criteria'.²¹ As the Auditor-General further commented:

While the ANAO has no fundamental issue with the Advisory Panel reaching a different view to the department as to the individual or relative merits of applications, at issue is that the panel did not then document an assessment of each application against each selection criterion to support or explain its recommendations. This approach, combined with the panel's meeting minutes not otherwise adequately outlining the rationale for decisions taken, means that the demotion of some projects and promotion of others compared with the only recorded ratings awarded against the selection criteria (being the department's) was unexplained.²²

2.20 There was interest in further understanding the categorisation of applications by the advisory panel – in particular, how the final overall scoring out of 50 for each application supported the categories of RFF, SFF and NRF.²³ The ANAO provided a detailed description of this process at the public hearing.²⁴ As the ANAO then summarised, 'the panel, as they

18 ANAO, Audit Report No. 9 (2014-15), p. 12.

19 ANAO, Audit Report No. 9 (2014-15), p. 24.

20 ANAO, Audit Report No. 9 (2014-15), p. 23.

21 ANAO, Audit Report No. 9 (2014-15), p. 23.

22 Mr McPhee, ANAO, 'Opening statement', *Submission 2*, p. 2.

23 For further detail on this aspect of the advisory panel's assessment approach, see ANAO, Audit Report No. 9 (2014-15), p. 91.

24 Mr Brian Boyd, Executive Director, ANAO, *Committee Hansard*, Canberra, 6 March 2015, pp. 2-3.

put it, assessed each application in its entirety and gave the entire application therefore a score and then added their individual scores together and compared them', but the 'problem' with that is it 'does not give you an insight into whether an application was seen as less worthy because its partnership funding was no good or its regional benefits were not as great'.²⁵ The department completed an individual assessment of each eligible application against each individual selection criterion and 'the panel, in its own words, challenged and re-rated that'.²⁶ However, while the ANAO agreed that that was a 'sound and good process; that is why you have a panel', the 'criticism' the ANAO had of the panel was that 'they did not then update those individual criterion assessments to reflect their views so that both we, looking in, and the minister could have the benefit of seeing that, and also unsuccessful applicants would have been able to be told, ultimately: "This is why you were unsuccessful. It was because you performed poorly here but well there"'.²⁷

2.21 In terms of the differing views of the advisory panel concerning a number of matters relating to the ANAO audit,²⁸ Mr Boyd, Executive Director, ANAO, further explained the ANAO's findings:

[the panel] are referring there to the issue ... about the notion as to whether it is adequate in the grants administration framework for them to conduct an overall assessment and come to an overall view against each application without supporting that, recording their assessment of each application in terms of each criterion. From our perspective, I guess we have a somewhat different view to the panel as well – and I think theirs is hard to support – as to what extent they have to operate in accordance with that grants administration framework. They argue in, I think, their first substantive point that they do not need to operate in accordance with that, because they are outside of it. I think we clearly point out that is not the case. I do not think the department disagrees with us ... The Commonwealth Grant Guidelines have been updated twice, and now they are the Commonwealth Grant Rules and Guidelines. The guidance to external panels in that has been made even more clear, because there has been some confusion for some panels about whether they have to do things in accordance with the framework. So the Department of Finance has made that

25 Mr Boyd, ANAO, *Committee Hansard*, Canberra, 6 March 2015, pp. 5-6.

26 Mr Boyd, ANAO, *Committee Hansard*, Canberra, 6 March 2015, p. 6.

27 Mr Boyd, ANAO, *Committee Hansard*, Canberra, 6 March 2015, p. 6.

28 For the advisory panel's response to the ANAO report, together with the ANAO comment, see Appendix 3, 'Former RDAF Advisory Panel's response', Audit Report No. 9 (2014-15), pp. 167-181.

abundantly clear, and one of the things that are a requirement is that the merit advice to ministers address the selection criteria ...

We have said, 'The department has done an assessment against each criterion to inform your work.' In their own words to us, they challenged and re-rated some of those, and we think that is a good and sound process. That is why they are employed. They are not employed just to tick what the department has done; there would be no point having them. But, in doing so, all they did was come up with different overall conclusions without explaining which of the criteria the department got it wrong on.²⁹

Minister's funding decisions

2.22 The ANAO report highlighted a number of matters regarding the ministerial advice provided by the department and the advisory panel for RDAF rounds three and four.³⁰ The ANAO concluded that the 'approach taken to advising the Minister as to which round three and four applications should be awarded funding had a number of significant shortcomings':

- applications were banded into a small number of categories, which offered the Minister limited assistance in terms of delineating the relative merits of competing applications;
- the briefing materials were voluminous, with insufficient summary material provided by the department. Such an approach makes it difficult for any decision-maker to compare the assessed merits of competing applications; and
- similar to the first round and notwithstanding the department agreeing to an ANAO recommendation that it enhance the documentation provided to the Minister to ensure assessment outcomes aligned with funding recommendations, the assessment of individual eligible applications against the published criteria (as recorded by the department and provided to the Minister) did not align with the panel's categorisation of applications.³¹

2.23 By way of background, the ANAO report found that, by ranking large numbers of applications equally by grouping them into a small number of bands, the advisory panel's approach 'represented a marked decline in the

29 Mr Boyd, ANAO, *Committee Hansard*, Canberra, 6 March 2015, pp. 13-14.

30 For the advisory panel's response to the ANAO report, together with the ANAO comment, see Appendix 3, 'Former RDAF Advisory Panel's response', Audit Report No. 9 (2014-15), pp. 167-181. Implementation of the ANAO report recommendations for the first RDAF funding round and DIRD's comments on this matter are further discussed in a later section.

31 ANAO, Audit Report No. 9 (2014-15), p. 26.

degree of differentiation offered to the Minister compared to the first funding round':

For rounds three and four, the extent to which the Minister did not approve applications categorised by the panel as RFF was considerably higher than round one but the Minister did not have the benefit of applications in the SFF category being individually ranked so that it was not possible for her to work through those applications in the manner that had occurred in round one.³²

- 2.24 The ANAO report also found that the round three and four briefing packages sent by the department to the then Minister did not contain a summary table – '[i]n the absence of summary information, the advice provided on how each RDAF application had been assessed against the selection criteria was not in a format that would have enabled the Minister to readily form her own conclusion as to how an individual application performed relative to competing applications'.³³ As the ANAO further explained, the results of the department's assessment were contained in 'assessment snapshots' – these were 'sent separately in hard copy format within multiple folders, with the Minister being sent 192 one-page assessment snapshots for round three, and 159 assessment snapshots averaging six pages each for round four'.³⁴ Exacerbating the situation was the fact that, according to the ANAO, the department 'made too many errors in the assessment snapshots'.³⁵
- 2.25 The ANAO further noted the constrained assessment time frames available to the department and the advisory panel in rounds three and four – 'the department's response back to us, quite fairly, points to the fact that they had less time to check things and get it right ... it would be wrong for us not to at least emphasise that to the committee. It does not excuse things, but ... it helps put things in a bit of context as well'.³⁶ DIRD confirmed that, while 'additional time would allow some greater quality assurance and reduce that particular risk ... we did not say that we could not do it at the right quality in the new time frames set'.³⁷
- 2.26 As the ANAO observed at the public hearing, 'there were a number of issues. Some of them would not have been visible, but the fact is that

32 ANAO, Audit Report No. 9 (2014-15), p. 23.

33 ANAO, Audit Report No. 9 (2014-15), p. 110.

34 ANAO, Audit Report No. 9 (2014-15), p. 110.

35 Mr Boyd, ANAO, *Committee Hansard*, Canberra, 6 March 2015, p. 5.

36 Mr Boyd, ANAO, *Committee Hansard*, Canberra, 6 March 2015, pp. 9-10. Mr Boyd also commented on some of things that the department recorded at the time as 'actions to undertake in light of reduced time frame', p. 10.

37 Ms Lyn O'Connell, Deputy Secretary, DIRD, *Committee Hansard*, Canberra, 6 March 2015, p. 10.

ministers, from our perspective, should be able to rely upon departments and panels getting that right for them'.³⁸

2.27 As well as a lack of alignment between departmental and advisory panel assessment stages for RDAF rounds three and four, the ANAO report pointed to a lack of alignment between assessment and funding stages:

A feature of the round three and round four decision-making was the lack of alignment with the assessment advice provided to inform those decisions. It is difficult to see such a result as being consistent with the competitive merit-based selection process outlined in the published program guidelines:

- only 53 (44 per cent) of the 121 approved applications had been assessed by the department as satisfying each of the published selection criteria. Further, among those applications not approved were 79 applications seeking a total of \$292 million that had been assessed as satisfying each selection criterion and as representing value with public money; and
- nearly half of the funding awarded (48 per cent) went to applications that had not been recommended by the panel and a third of recommended applications were not approved.

Specifically, the Minister:

- ⇒ rejected 41 projects that had been recommended for funding of \$93 million; and
- ⇒ approved \$109 million in funding for 33 projects that had not been recommended by the panel.³⁹

2.28 It is noted that a third of the applications awarded the highest possible rating against each selection criteria by the department were assigned to the lowest merit category by the panel.⁴⁰

2.29 As the Auditor-General further observed:

The then Minister approved 88 of the 129 applications that had been recommended for funding by the panel across rounds three and four, and so rejected the other 41 applications. In addition, the then Minister approved 33 applications that had not been recommended for funding, of which 10 had been categorised as 'Suitable for Funding' and 23 had been categorised as 'Not Recommended for Funding' by the panel. Therefore, 27 per cent of the applications approved (representing 48 per cent of the \$226 million awarded) had not been recommended for funding by the panel.⁴¹

38 Mr Boyd, ANAO, *Committee Hansard*, Canberra, 6 March 2015, p. 6.

39 ANAO, Audit Report No. 9 (2014-15), p. 27.

40 ANAO, Audit Report No. 9 (2014-15), p. 15.

41 Mr McPhee, ANAO, 'Opening statement', *Submission 2*, p. 3.

- 2.30 The Auditor-General emphasised the broader point that ‘when you look ... at ... the minister’s funding decisions, you can see that the minister is approving applications from not only the SFF ... but also from the NRF as well. So, ours is a broader point ... The minister was recommended by the panel to just go with the top level. For whatever reason, she has moved more broadly into the full range of categories, just not the SFF categories’.⁴²
- 2.31 A related issue that emerged here concerned a difference in opinion as to whether or not RDAF projects classified as ‘Suitable for Funding’ were available for selection by the Minister, and whether or not the Minister therefore had to report to the Finance Minister approval of any grant application from this category.⁴³ As the ANAO report explained:
- In each of the four rounds, the panel recommended that funding be approved only for those applications it had included in the ‘Recommended for Funding’ category ... However, the Minister has informed the ANAO that: she had been advised by the department, and was always of the understanding, that projects in both the ‘Recommended for Funding’ and ‘Suitable for Funding’ categories were available for selection; in choosing projects from both categories she was complying with the program guidelines; and she would have reported to the Finance Minister her decisions to award funding to an application included in the ‘Suitable for Funding’ category if she had believed that the panel had not recommended them for funding.⁴⁴
- 2.32 The ANAO noted that they and the department held different perspectives on whether there was a requirement for the Minister to report to the Finance Minister on RDAF funding applications approved from the SFF category: ‘[o]ur perspective was that they did, and it was the same perspective we had in round 1. The department ... has held the same perspective throughout as well: it does not consider that they require reporting to the finance minister’.⁴⁵ As DIRD confirmed, ‘[o]ur view ... was that those projects that were not recommended for funding needed to be advised ... we did not advise that those that were suitable for funding and selected by the minister needed to be advised ... So the difference here is between the ANAO’s view of the guidelines and ours. We recommended to the minister that she advise the Minister for Finance only

42 Mr McPhee, ANAO, *Committee Hansard*, Canberra, 6 March 2015, p. 8. See also Mr Boyd, ANAO, on this point, p. 9.

43 In the context of the grants administration framework there is an ‘obligation to report to the Finance Minister instances where a Minister approves ... any applications that were recommended for rejection’ – see ANAO, *Audit Report No. 9 (2014-15)*, p. 134.

44 ANAO, *Audit Report No. 9 (2014-15)*, p. 17. See the response of the then Minister to the ANAO report and the ANAO comment at Appendix 2, pp. 164-166.

45 Mr Boyd, ANAO, *Committee Hansard*, Canberra, 6 March 2015, p. 12.

where they were not recommended'.⁴⁶ The public hearing further explored this difference in viewpoint concerning whether or not RDAF projects classified as 'SFF' were available for selection by the Minister, and whether or not the Minister therefore had to report to the Finance Minister approval of any grant application from this category – this discussion is cited in full at Figure 2.1.

- 2.33 In terms of documenting grant funding decisions, the ANAO report observed that the 'grants administration framework has been designed to accommodate situations where decision-makers do not accept the advice they receive. Amongst other things, it requires that the basis for funding decisions be recorded'.⁴⁷ As the Auditor-General stated, '[w]hile it is open to a Minister to reach a decision different from that recommended by a panel or department, it is important that the rationale for such decisions be documented and be consistent with the published program guidelines and with any other applicable Commonwealth policies and legislation'.⁴⁸ However, the Auditor-General noted that, 'where the then Minister's funding decisions diverged from the panel's recommendations in rounds three and four, the recorded reasons did not refer explicitly to the published selection criteria and generally provided little insight'.⁴⁹ As the ANAO report observed, the records instead 'tended toward generalised statements'.⁵⁰ At the public hearing, the ANAO provided examples of such statements,⁵¹ and further noted that:

the [ANAO] report recognises ... that ministers have that discretion to make decisions which differ from the recommendations ... one of the key things we looked to, in accordance with the grants administration framework, is that ministers adequately record their reasons for decisions ... The challenge here is that in a small number of instances ... no reason was recorded. In others the reason was often the same reason repeated again and again, often 'not sufficient regional benefit'. In terms of the selection criteria, from our perspective, that provides little insight as to why some projects that were recommended are being moved past.⁵²

46 Ms O'Connell, DIRD, *Committee Hansard*, Canberra, 6 March 2015, pp. 12-13.

47 ANAO, Audit Report No. 9 (2014-15), p. 18.

48 Mr McPhee, ANAO, 'Opening statement', *Submission 2*, p. 3.

49 Mr McPhee, ANAO, 'Opening statement', *Submission 2*, p. 3.

50 ANAO, Audit Report No. 9 (2014-15), p. 28.

51 Mr Boyd, ANAO, *Committee Hansard*, Canberra, 6 March 2015, pp. 11-12.

52 Mr Boyd, ANAO, *Committee Hansard*, Canberra, 6 March 2015, p. 7, p. 9.

Figure 2.1 *Committee Hansard, Canberra, 6 March 2015, pp. 7-8 (Mr Pat Conroy MP, Deputy Chair, JCPAA; Mr Brian Boyd, ANAO; and Ms Lyn O'Connell, DIRD)*

Mr CONROY: ... It seems to be very clear in the audit process that the department at the time considered 'suitable for funding' as consistent with the guidelines. I would like to draw everyone's attention to the guidelines for RDAF round 4 ...

The panel may choose to consider the distribution of funding of projects rated 'recommended for funding' or 'suitable for funding' in its recommendations to the minister ... page 137 of the [ANAO] report on the same issue ... details how the department provided advice to the minister around notification to the Minister for Finance for projects that she had approved, but that were not recommended. It is true to say that ... advice ... does not recommend that the minister must notify the Department of Finance when she approved projects that were classified 'suitable for funding'.

Ms O'Connell: My understanding is that it was restricted to the not-suitable-for-funding category, which is what we understand to be the right practice.

Mr CONROY: So we have clear guidelines that say that the panel can recommend projects ranked 'suitable for funding'. We have clear advice from the department to the minister that she does not need to notify the Minister for Finance when she approves projects that are classified 'suitable for funding'. Mr Boyd, is it true that you are siding with the panel's assessment, but it seems that the minister had very clear advice from the department and had guidelines to rely on that suitable-for-funding projects were projects she could approve?

Mr Boyd: I would not agree with that. Rather than having me talking in the abstract on this, I might read into the record the actual advice that the minister received. Yes, the guidelines did allow that capacity for the panel or the department to recommend that the minister approve not only those in the RFF top bucket, but also the suitable-for-funding second bucket. But that is not what happened. This is from the opening paragraph of the round 3 brief; I will then read the opening paragraph from the round 4 brief, which contains the recommendation:

The Chair has written to you recommending that 95 projects be funded at a cost of up to \$38.59 million.

Those are the ones in the RFF category. There was no recommendation that she also fund the SFF. Similarly the opening paragraph of the round 4 brief – the key recommendation – says:

The Chair has written to you recommending that 34 projects be funded at a cost of up to \$172,474,143.

It refers to an attachment A. Attachment A is an attachment to the panel's letter, which lists each of those projects. Again, those projects, which are described as a list of projects recommended by the panel for funding, are only those in the recommended for funding bucket. So, yes, the guidelines provided that capacity, and ... the panel considered distribution in coming to its recommendations ... But then the panel came to the considered view, as clearly expressed in both briefs, that the only projects they are recommending for funding are those in the recommended for funding bracket.

Mr CONROY: Mr Boyd, what I am focused on here is, firstly, that the guidelines clearly imply that both categories are able for approval by the minister and, secondly, the clear advice from the department, as confirmed by testimony just given by Ms O'Connell that she does not have to notify the Minister for Finance when she approves projects considered suitable for funding, which would seem to imply that the minister considered, on departmental advice, that she was acting consistently with the grant guidelines ...

... my broader point is that we have already established, through the report and the testimony, that the panel and the department's assessment of who fitted into those categories was incredibly flawed. So the minister's selection of projects outside that was fine. Additionally, the current minister has confirmed that assessment by continuing with those projects that were not recommended by the panel.

2.34 As the Auditor-General concluded, '[w]e do not have a problem with different steps and stages taking a different view. In fact, we fully expect that to happen ... Our only point is that the process should be quite clear about each responsible area making the call, but being clear as to the basis for the decision ... we are respectful of the different views that different parts of the process may have along the way; but please be accountable for the calls that you make and document them'.⁵³

2.35 There was interest in further exploring the RDAF arrangements following the change of government⁵⁴ on the basis that the current Minister had continued to fund all the projects in rounds three and four that the previous Minister had determined to fund – in particular, concerning the information that the current Minister had received from the department on these projects and whether in fact it would be unusual for a new incoming government to withdraw grant funding from applicants who had already been notified that they were successful. DIRD confirmed that '[a]ll grants for rounds 3 and 4 were continued and funded'.⁵⁵ DIRD further confirmed that this included 'dozens and dozens' of grants that were uncontracted when change of Government occurred.⁵⁶ DIRD also explained that:

... we provided the current government with a list of projects that were successful and unsuccessful – not the information and briefings we provided to the minister of the previous government but the end outcomes of successful and unsuccessful grant applicants – and the recommendations of the panel as well in order to inform the government's decision making about whether they would proceed with funding those grants or not ... as part of aiding their decision-making process, we provided information on our assessment of the project, the panel's view and what was funded and not funded ...

There was a decision point with the change of government as to whether they would continue to fund them or not, particularly where they were not yet contracted. Where they were contracted, they were continuing. That was a commitment of the current government as it came to government. But this was to aid decision making about those not contracted grants ...

53 Mr McPhee, ANAO, *Committee Hansard*, Canberra, 6 March 2015, p. 14.

54 By way of background, at the time of the change of government in September 2013, '57 of the projects approved in rounds two to four of RDAF did not have a signed funding agreement', ANAO, Audit Report No. 9 (2014-15), p. 39.

55 Ms O'Connell, DIRD, *Committee Hansard*, Canberra, 6 March 2015, p. 5.

56 Mr McCormick, DIRD, *Committee Hansard*, Canberra, 6 March 2015, p. 14, p. 24.

The government of the day chose to go ahead with contracting rounds 3 and 4 contract[s] where they had not yet been contracted. The government of the day chose not to proceed with any of the round 5 contracts. No discussions had been held about those contracts with the proponents.⁵⁷

We provide advice, a brief, to the minister with a recommendation to fund or not to fund, based on the value-for-money assessment.⁵⁸

- 2.36 It is noted that successful recipients of round five RDAF grants had been notified.

Transparency and accountability

- 2.37 The ANAO report concluded that, '[i]n a number of important respects, the conduct of the third and fourth RDAF funding rounds was not consistent with the accountability and transparency principles outlined in the grants administration framework' – and of 'particular note' here was that the recording of reasons for funding decisions 'did not adequately explain how the preference evident for projects located in Australian Labor Party (ALP)-held electorates had resulted from a merit-based process. In particular, those projects had a much higher approval rate than those located in Coalition-held electorates'.⁵⁹
- 2.38 As the Auditor-General noted, 'where the then Minister's funding decisions diverged from the panel's recommendations in rounds three and four, the recorded reasons did not refer explicitly to the published selection criteria and generally provided little insight. This situation was particularly significant given that such decisions were largely at the expense of projects located in electorates held by the Coalition'.⁶⁰
- 2.39 The Committee noted that 10 out of 23 projects rated 'Not Recommended for Funding' subsequently selected for funding were located in non-Labor held seats (including four Coalition and five Independent).⁶¹
- 2.40 The ANAO confirmed that it was 'quite common' for relevant ANAO reports to consider the electoral distribution of funding,⁶² and that the ANAO Better Practice Guide on *Implementing Better Practice Grants*

57 Ms O'Connell, DIRD, *Committee Hansard*, Canberra, 6 March 2015, p. 4, p. 24.

58 Mr McCormick, DIRD, *Committee Hansard*, Canberra, 6 March 2015, p. 14.

59 ANAO, Audit Report No. 9 (2014-15), p. 29.

60 Mr McPhee, ANAO, 'Opening statement', *Submission 2*, p. 3. See the response of the then Minister to the ANAO report and the ANAO comment at Appendix 2, pp. 164-166.

61 Mr Boyd, ANAO, *Committee Hansard*, Canberra, 6 March 2015, p. 20. See also ANAO, Audit Report No. 9 (2014-15), p. 128.

62 Mr McPhee, ANAO, *Committee Hansard*, Canberra, 6 March 2015, p. 19. The ANAO pointed to a number of audit reports that had included this information – see *Submission 2.1*, p. 2.

*Administration*⁶³ and Commonwealth Grants Rules and Guidelines also make reference to analysis of electoral distribution as a measure to evaluate the equity of a program:

The ANAO has observed that, in its performance audits of grant programmes, it has put an emphasis on the geographic distribution of certain grant programmes as a measure of equitable distribution and as an indicator of party-political bias in the distribution of grants. The ANAO has emphasised that those involved in grants administration should therefore be aware that the geographic and political distribution of grants may be seen as indicators of the general equity of a programme.⁶⁴

- 2.41 It was pointed out that the distribution by political party of total funding approved for RDAF rounds one to four was 46 per cent for the Australian Labor Party and 46 per cent for the Coalition, with Coalition seats receiving \$4.5 million more than ALP seats across the four funding rounds.⁶⁵ However, the ANAO report noted that ‘while electorates held by the two major parties were awarded an equal portion of the \$575.8 million approved in total across the four funding rounds (being 46 per cent each), this result did not align with the distribution of funding requested or recommended’; rather, ‘projects located in Coalition-held electorates had represented both the majority of the RDAF funding requested (55 per cent) and the majority of the funding recommended (59 per cent) but were less successful in being awarded funding (46 per cent)’.⁶⁶
- 2.42 The ANAO’s use of an Australian Electoral Commission (AEC) classification of electorates as ‘rural or provincial’ was further discussed at the public hearing.⁶⁷ (The ANAO report had made reference to one of its findings as being ‘consistent with the extent to which the Coalition held electorates defined by the Australian Electoral Commission as rural or provincial’.⁶⁸)

63 See ANAO, *Implementing Better Practice Grants Administration*, Better Practice Guide, December 2013, p. 94 – quoted in ANAO, *Submission 2.1*, pp. 2-3.

64 *Commonwealth Grants Rules and Guidelines*, Department of Finance, July 2014, paragraph 13.9, p. 35 – quoted in ANAO, *Submission 2.1*, p. 3.

65 See ANAO, Table 6.2, ‘Distribution by political party of total funding approved under rounds one to four’, Audit Report No. 9 (2014-15), p. 151.

66 ANAO, Audit Report No. 9 (2014-15), pp. 150-151.

67 See Mr Boyd, ANAO, *Committee Hansard*, Canberra, 6 March 2015, pp. 19-22; and Mr McCormick, DIRD, *Committee Hansard*, Canberra, 6 March 2015, pp. 20-21. DIRD provided further details about the applications received in RDAF round four, including how many were identified as having a project located in a capital city, as well as details of the key points of difference between the program guidelines for rounds three and four – see *Submission 1.2*, pp. 1-2.

68 ANAO, Audit Report No. 9 (2014-15), pp. 150-151.

- 2.43 By way of background, the purpose of RDAF round three was to ‘support projects in towns with a population of 30 000 people or less’, while round four ‘sought to support strategic infrastructure projects, which could be located in any Australian town or city’.⁶⁹ The program guidelines for round four further advised that ‘projects located in a capital city must demonstrate how the project will benefit the broader region’ – however, there was ‘no requirement that regional Australia be a beneficiary of the projects located in capital cities’.⁷⁰
- 2.44 ANAO reference to the AEC classification of electorates as ‘rural or provincial’ was therefore queried on the basis that, firstly, a number of electorates classified by the AEC as ‘outer metropolitan’ – and so excluded from the ‘rural or provincial’ classification – also take in regional towns (a range of electorates containing regional communities do not align precisely with the AEC’s definition of ‘rural or provincial’ electorates); and, secondly, RDAF funded some projects in urban areas to the benefit of the broader region, rather than regional Australia specifically.
- 2.45 On another matter, DIRD was asked if it was standard practice for information to be publicly disclosed about whether grant applications not approved by a minister had been recommended by a panel or department and, alternatively, about whether grant applications approved by a minister had not been recommended by a panel or department. Ms Lyn O’Connell, Deputy Secretary, DIRD, responded that ‘[m]y observation of practice is that it is not common for such information to be made public’.⁷¹ As DIRD further explained, ‘[w]hen grant decisions are made it is common practice that the minister will make public the successful recipients. Usually there is a letter to the unsuccessful applicants. But it is not common practice that either the department or necessarily the minister would make public the list of unsuccessful grant applicants’.⁷²
- 2.46 There was also interest in who, beyond the department, might have received information about projects recommended but not approved and projects approved but not recommended.⁷³ DIRD confirmed that, in addition to the department and the then Minister, the panel members and the incoming Assistant Minister for Infrastructure and Regional Development received this information.⁷⁴

69 ANAO, Audit Report No. 9 (2014-15), p. 41, p. 43.

70 ANAO, Audit Report No. 9 (2014-15), p. 66, p. 67.

71 Ms O’Connell, DIRD, *Committee Hansard*, Canberra, 6 March 2015, p. 4.

72 Ms O’Connell, DIRD, *Committee Hansard*, Canberra, 6 March 2015, p. 4.

73 DIRD provided further explanation on this point – see Ms O’Connell, DIRD, *Committee Hansard*, Canberra, 6 March 2015, pp. 4-5.

74 Ms O’Connell, DIRD, *Committee Hansard*, Canberra, 6 March 2015, p. 4.

Implementation of ANAO report recommendations

- 2.47 The ANAO conducted a previous audit of the design and conduct of RDAF round one in September 2012, making three recommendations, as set out in Table 2.3.⁷⁵
- 2.48 There was interest in how the department had implemented these previous recommendations. The ANAO report observed that the department had 'agreed to all three recommendations' from this previous audit and noted it would 'adopt the recommendations in round three and subsequent funding rounds'.⁷⁶ However, the ANAO concluded that:

The absence of alignment or a clear trail between the assessed merit of applications against the published selection criteria and the rounds three and four funding decisions was a similar situation to that observed in ANAO's audit of the first RDAF funding round. This shows that the recommendations made in the first audit, agreed by the department, had not been implemented by the department ... Effectively implementing agreed recommendations (which often reflect ANAO's experience of practices other departments have found to be beneficial) and closer adherence to identified principles of better practice grants administration are matters that warrant greater attention by the department.⁷⁷

Table 2.3 ANAO recommendations, Report No. 3 (2012-13)

1	To provide a more efficient and effective means of differentiating between eligible applications in terms of their overall claims against the published assessment criteria, ANAO recommends that the Department of Regional Australia, Local Government, Arts and Sport, in consultation with the Regional Development Australia Fund advisory panel, adopt a numerical rating scale for the merit assessment stage of future funding rounds. Regional Australia response: <i>Agree.</i>
2	In designing and administering grant programs, ANAO recommends that the Department of Regional Australia, Local Government, Arts and Sport clearly outline to decision-makers the basis on which it has been assessed whether each application represents value for money in the context of the published program guidelines and program objectives. Regional Australia response: <i>Agree.</i>
3	ANAO recommends that, consistent with the key principles for grants administration outlined in the Commonwealth Grant Guidelines, the Department of Regional Australia, Local Government, Arts and Sport improve the documentation provided to the Minister in respect to the assessment of individual eligible applications against the published criteria to promote a clear alignment between these assessments and the order of merit for funding recommendations. Regional Australia response: <i>Agree.</i>

75 ANAO, Audit Report No. 3 (2012-13), *Design and Conduct of the First Application Round for the Regional Development Australia Fund*, DRALGAS, pp. 28-29.

76 ANAO, Audit Report No. 9 (2014-15), p. 40.

77 ANAO, Audit Report No. 9 (2014-15), p. 16.

- 2.49 By way of background, 'instead of fully implementing these recommendations', the ANAO found that the department had retained the 'same qualitative rating scale it had used in the first funding round' and an 'unsound methodology for assessing value with public money'.⁷⁸ Further, 'notwithstanding the department agreeing to an ANAO recommendation that it enhance the documentation provided to the Minister to ensure assessment outcomes aligned with funding recommendations', the assessment of individual eligible applications against the published criteria, as recorded by the department and provided to the Minister, 'did not align with the panel's categorisation of applications'.⁷⁹
- 2.50 However, DIRD considered that it had implemented these recommendations: '[w]hile the ANAO report for Rounds Three and Four indicated that, in their view, the recommendations from Round One had not been implemented, the Department disagrees and considers that it has implemented the recommendations'.⁸⁰ At the public hearing, DIRD provided further details on how it had implemented these recommendations.⁸¹
- 2.51 There was also interest in DIRD's progress in implementing the ANAO recommendations from the current audit report, for RDAF rounds three and four. The department provided an update on its implementation of these recommendations.⁸²

Better practice regional grants administration

- 2.52 The ANAO report concluded that, in the context of improving grants administration, the 'most important message' from its audit of RDAF rounds three and four is that 'considerable work remains to be done to design and conduct regional grant programs in a way where funding is awarded, and can be seen to have been awarded, to those applications that demonstrate the greatest merit in terms of the published program guidelines'.⁸³
- 2.53 As the ANAO further noted, while performance audits have been undertaken of 'each of the major regional grant funding programs introduced by successive governments over the last eleven years' and

78 ANAO, Audit Report No. 9 (2014-15), p. 22.

79 ANAO, Audit Report No. 9 (2014-15), p. 26.

80 DIRD, *Submission 1*, p. 1.

81 Ms O'Connell, DIRD, *Committee Hansard*, Canberra, 6 March 2015, p. 2. For further details on this matter, see also DIRD, *Submission 1*, pp. 2-3.

82 See Ms O'Connell, DIRD, *Committee Hansard*, Canberra, 6 March 2015, p. 1.

83 ANAO, Audit Report No. 9 (2014-15), p. 21.

‘improvements have been observed in some important aspects of the design and implementation of regional grant programs’ over this period, for each successive program there have been ‘shortcomings in the design and administration of the assessment and decision-making processes, and indicators of bias in the awarding of funding to government-held electorates’.⁸⁴

- 2.54 Accordingly, there was interest in how regional grants program administration might be improved in the future. As the JCPAA Chair observed:

These sorts of programs have been prone to these sorts of problems. How do we do better? We have talked about the better practice guide. We have had numerous recommendations, and you have outlined them in your report, and the recommendations have all been agreed. But we keep coming back to this point ... You could probably have a stack of Audit Office reports on regional programs, but how do we get it right?⁸⁵

- 2.55 The Auditor-General concluded by emphasising the ‘long-term gain’ from such audit processes over time and the importance of ministers calling for good practice from their departments:

Our work is really, genuinely designed to stimulate better administration in the long term. There is a bit of short-term pain, but there is long-term gain from these audit processes and the responses by the department. I think the reason we issue the better practice guide is to try and bring together all of our collective experience, which draws off agencies’ experiences as well, and put it out there. I think, though, there is nothing more important than the ministers saying to their departments, ‘I want a good practice process here.’ There are risks when timetables get shortened. We see it more broadly in public administration. When agencies operate under time pressures the risks do go up. But it is up to agencies to manage those risks or to inform government, if they cannot, what other options might be available ... with the committee’s support, our continuing work and the positive and constructive responses from departments, we will get a better outcome, an outcome that still is respectful of the roles of the different parties in the process and, at the end of the day, of the responsibilities of ministers to make decisions.⁸⁶

84 ANAO, Audit Report No. 9 (2014-15), pp. 19-20.

85 Dr Southcott MP, Chair, JCPAA, *Committee Hansard*, Canberra, 6 March 2015, p. 23.

86 Mr McPhee, ANAO, *Committee Hansard*, Canberra, 6 March 2015, p. 23.

- 2.56 Against this background, there was also interest in the broader design of the current regional grants program being administered by DIRD, the National Stronger Regions Fund (NSRF),⁸⁷ as well as how the department was implementing ANAO recommendations from current and past audits in terms of this new program. DIRD provided further details about this matter,⁸⁸ and confirmed that, in designing the NSRF, 'we have had regard to the ANAO's findings in relation to all of its audits on regional programs, particularly its latest audit on rounds 3 and 4. We believe we have taken into account the ANAO's recommendations and adjusted the way that program will operate accordingly'.⁸⁹
- 2.57 DIRD explained that it was currently going through the process of assessing submissions for round one of NSRF and that it would then 'provide advice to the ministerial panel, which in consultation with the government will make decisions on which applications they will fund'.⁹⁰ DIRD also confirmed that there would be 'further rounds' of funding for the NSRF and therefore 'some flexibility' in how much money there would be for the first round.⁹¹ The ANAO made some initial observations on these matters in terms of the design and funding of the NSRF.⁹²
- 2.58 It was noted that the design and implementation of NSRF was listed as a potential audit in the ANAO's 2014 Audit Work Program.⁹³

Committee comment

Assessment and funding stages

- 2.59 A key conclusion of the ANAO audit, as noted by the Auditor-General, was that there was 'not a clear trail through the various assessment stages adopted in [RDAF] rounds three and four to demonstrate that the projects recommended for funding, and those ultimately awarded funding, had

87 The NSRF is a competitive regional grants program to fund priority infrastructure in regional communities, with \$1 billion in funding to be provided over five years from 2015-16 – see DIRD website on the NSRF, <http://investment.infrastructure.gov.au/funding/NSRF> (accessed May 2015).

88 See Mr Andrew Jagers, Executive Director, Infrastructure Investment Division, DIRD, *Committee Hansard*, Canberra, 6 March 2015, pp. 15-17, 23.

89 Mr Jagers, DIRD, *Committee Hansard*, Canberra, 6 March 2015, p. 15.

90 Ms O'Connell, DIRD, *Committee Hansard*, Canberra, 6 March 2015, p. 15.

91 Mr Jagers, DIRD, *Committee Hansard*, Canberra, 6 March 2015, p. 17.

92 Mr Boyd, ANAO, *Committee Hansard*, Canberra, 6 March 2015, p. 17.

93 Mr Boyd, ANAO, *Committee Hansard*, Canberra, 6 March 2015, p. 15 – see ANAO, *Audit Work Program*, July 2014, p. 90.

the greatest merit in terms of the published selection criteria'.⁹⁴ (Differing views expressed by the RDAF advisory panel and the then Minister on some aspects of the ANAO report are noted below.)

- 2.60 In terms of the department's role in assessing RDAF applications, the Committee was pleased to note the ANAO's finding that 'improvements in the quality of the department's assessment work' evident from the first RDAF round audited by ANAO 'continued in the third and fourth funding rounds'.⁹⁵ However, the Committee notes that the ANAO found there remained 'significant shortcomings' with the department's assessment methodology for rounds three and four, including that: the qualitative rating scale used by the department did not provide a 'clear and consistent basis for effectively discriminating between the relative merits of competing applications'; there was an 'unsound methodology for assessing value with public money'; and the department had not fully implemented recommendations from the previous ANAO report on the first RDAF round designed to address these shortcomings.⁹⁶ (Implementation of ANAO recommendations by the department and DIRD's comments on this matter are further discussed below.)
- 2.61 In terms of the advisory panel's role in assessing RDAF applications, the Auditor-General pointed to concerns with the panel not having documented an assessment of each application against each selection criterion to support or explain its recommendations.⁹⁷ While the ANAO has no fundamental issue with the advisory panel reaching a different view from the department as to the individual or relative merits of applications, as the Auditor-General noted, this approach meant that the 'demotion of some projects and promotion of others compared with the only recorded ratings awarded against the selection criteria (being the department's) was unexplained'.⁹⁸
- 2.62 The Committee supports the ANAO's recommendations to address this matter from the current and previous RDAF audits. In particular, the Committee supports the ANAO recommendation that, in its administration of future grants programs and consistent with the key principles for grants administration outlined in the Commonwealth Grants Rules and Guidelines, DIRD – working with advisory panels, where relevant – improve the assessment of individual applications against each of the published program selection criteria to promote a clear

94 Mr McPhee, ANAO, 'Opening statement', *Submission 2*, p. 2.

95 ANAO, Audit Report No. 9 (2014-15), p. 22.

96 ANAO, Audit Report No. 9 (2014-15), p. 22.

97 Mr McPhee, ANAO, 'Opening statement', *Submission 2*, p. 2.

98 Mr McPhee, ANAO, 'Opening statement', *Submission 2*, p. 2.

alignment between these assessments and the order of merit for funding recommendations. The Committee also believes there may be merit in the ANAO considering the inclusion of a specific reference, where relevant, in the objective, scope and criteria of future audits of regional grants administration to assessing how advisory panels have met their obligations under the Commonwealth Grants Rules and Guidelines, to further reinforce the significance of this matter.

- 2.63 The advisory panel's response to the ANAO report and the ANAO comment on this matter are noted.⁹⁹ The Committee believes there may be merit in the Department of Finance and the ANAO reviewing whether the Commonwealth Grants Rules and Guidelines and section 3.2.2, 'Use of an advisory panel in the selection of grant recipients', of the *Implementing Better Practice Grants Administration* guide could usefully be further revised to reinforce the ANAO's RDAF audit findings concerning the obligations of advisory panels in grant funding programs, particularly in terms of documentation and published program selection criteria.
- 2.64 In terms of the then Minister's funding decisions, the Committee notes the ANAO's finding that the approach taken by the department and the advisory panel to advising the then Minister as to which RDAF round three and four applications should be awarded funding had a number of 'significant shortcomings', including that applications were 'banded into a small number of categories', offering the then Minister 'limited assistance in terms of delineating the relative merits of competing applications', and that the briefing materials were 'voluminous', with insufficient summary material provided by the department, making it 'difficult for any decision-maker to compare the assessed merits of competing applications'.¹⁰⁰ This was exacerbated by numerous errors in the snapshot assessments and significant differences in assessment of projects between DIRD and the panel that covered at least a third of applications. Further, notwithstanding that the department had indicated it would review and enhance the documentation provided to the Minister to ensure the outcomes of the assessment aligned with the order of merit for funding recommendations, 'no improvement was evident in this regard'.¹⁰¹ As the ANAO commented, 'there were a number of issues. Some of them would not have been visible, but the fact is that ministers, from our perspective,

99 For the advisory panel's response to the ANAO report, together with the ANAO comment, see Appendix 3, 'Former RDAF Advisory Panel's response', Audit Report No. 9 (2014-15), pp. 167-181.

100 ANAO, Audit Report No. 9 (2014-15), p. 26.

101 ANAO, Audit Report No. 9 (2014-15), p. 131.

should be able to rely upon departments and panels getting that right for them'.¹⁰²

- 2.65 The Committee supports the ANAO recommendation to improve the quality and clarity of future advice provided by the department to ministers on the merits of proposed grants under a merit based competitive selection process – in particular, that DIRD provide advice that clearly and consistently establishes the comparative merit of applications relative to the program guidelines and merit criteria, and includes a high level summary of the assessment results of each of the competing proposals in terms of their merit against the published criteria.
- 2.66 As well as significant disagreements regarding assessment rankings between the department and the advisory panel for RDAF rounds three and four, the ANAO pointed to a lack of alignment between assessment and funding stages – specifically, that the then Minister rejected 41 applications that had been recommended for funding by the advisory panel and approved 33 applications that had not been recommended – of which 10 had been categorised as 'Suitable for Funding' and 23 had been categorised as 'Not Recommended for Funding' by the panel.¹⁰³
- 2.67 An issue that emerged here concerned a difference in opinion as to whether or not RDAF projects classified as 'Suitable for Funding' were available for selection by the Minister, and whether or not the Minister therefore had to report to the Finance Minister approval of any grant application from this category.¹⁰⁴ The response of the then Minister to the ANAO report as regards this matter and the ANAO comment are noted.¹⁰⁵ DIRD confirmed at the Committee hearing that the Minister followed the clear advice of the department regarding which project selections required notice being given to the Finance Minister. These projects were then reported to the Finance Minister.¹⁰⁶ The Committee agrees with the ANAO that the then Minister's response highlights that the 'Suitable for Funding' descriptor was 'not a particularly helpful descriptor' and that this points to the benefit of DIRD, in future granting activities, providing a clear statement for each grant proposal to either approve or reject the proposal.¹⁰⁷ This would in turn improve clarity in terms of determining the requirement to report to the

102 Mr Boyd, ANAO, *Committee Hansard*, Canberra, 6 March 2015, p. 6.

103 Mr McPhee, ANAO, 'Opening statement', *Submission 2*, p. 3.

104 See *Committee Hansard*, Canberra, 6 March 2015, pp. 7-8, pp. 12-13; and ANAO, Audit Report No. 9 (2014-15), pp. 17-18.

105 See the response of the then Minister to the ANAO report and the ANAO comment at Appendix 2, Audit Report No. 9 (2014-15), pp. 164-166.

106 Ms O'Connell, DIRD, *Committee Hansard*, Canberra, 6 March 2015, p. 7.

107 ANAO, Audit Report No. 9 (2014-15), p. 29.

Finance Minister on such matters. The Committee believes there may be merit in the Department of Finance and the ANAO reviewing whether the Commonwealth Grants Rules and Guidelines and the *Implementing Better Practice Grants Administration* guide could usefully be further revised to reinforce this point.

- 2.68 However, the Committee notes that the ANAO pointed to a broader issue here regarding the requirement for decision-makers to record the basis for funding decisions. As the Auditor-General observed, while it is open to a Minister to reach a decision different from that recommended by an advisory panel or department, 'it is important that the rationale for such decisions be documented and be consistent with the published program guidelines and with any other applicable Commonwealth policies and legislation'. However, where the then Minister's funding decisions diverged from the recommendations of the advisory panel in RDAF rounds three and four, the 'recorded reasons did not refer explicitly to the published selection criteria and generally provided little insight'.¹⁰⁸ The Committee notes that the grants administration framework has been 'designed to accommodate situations where decision-makers do not accept the advice they receive' and, amongst other things, 'it requires that the basis for funding decisions be recorded'.¹⁰⁹
- 2.69 The Committee makes recommendations concerning these matters below.

Transparency and accountability

- 2.70 The ANAO found that, in a number of important respects, the conduct of the third and fourth RDAF funding rounds was 'not consistent with the accountability and transparency principles outlined in the grants administration framework'.¹¹⁰ In terms of the funding decisions that diverged from the advisory panel's recommendations in rounds three and four, the Auditor-General noted that this 'situation was particularly significant given that such decisions were largely at the expense of projects located in electorates held by the Coalition'.¹¹¹
- 2.71 Despite the shortcomings identified in the ANAO report, the Committee notes that the incoming Minister made a decision to continue and fund all projects in rounds three and four. This included both contracted and uncontracted projects.¹¹²

108 Mr McPhee, ANAO, 'Opening statement', *Submission 2*, p. 3.

109 ANAO, Audit Report No. 9 (2014-15), p. 18.

110 ANAO, Audit Report No. 9 (2014-15), p. 29.

111 Mr McPhee, ANAO, 'Opening statement', *Submission 2*, p. 3.

112 Ms O'Connell, DIRD, *Committee Hansard*, Canberra, 6 March 2015, p. 5.

- 2.72 The ANAO explained that it was common practice for relevant ANAO reports to consider the electoral distribution of funding as a measure to evaluate program equity.¹¹³ The Committee understands that the ANAO Better Practice Guide on *Implementing Better Practice Grants Administration* and the Commonwealth Grants Rules and Guidelines also make reference to this matter.¹¹⁴
- 2.73 The Committee supports the continuing emphasis on this area in relevant ANAO audits in order to continue to improve transparency and accountability in grants administration. The Committee also supports the emphasis that the Commonwealth Grants Rules and Guidelines have placed on this area, in specifically making reference to the ANAO's practice concerning this matter: '[T]he ANAO has emphasised that those involved in grants administration should ... be aware that the geographic and political distribution of grants may be seen as indicators of the general equity of a programme'.¹¹⁵
- 2.74 The Committee notes the issues raised at the public hearing concerning the ANAO's reference in its report to an AEC classification of electorates as 'rural or provincial'.¹¹⁶ The Committee notes that some electorates classified as 'outer metropolitan' contain regional areas.¹¹⁷ The Committee suggests that in the next update of the Better Practice Guide, *Implementing Better Practice Grants Administration* – specifically regarding section 8.8, 'Equity of distribution of program funds' – the ANAO (in consultation with the AEC as required) may wish to further clarify its potential use of such AEC classifications in its performance audit reports.
- 2.75 The Committee makes recommendations concerning these matters below.

Implementation of ANAO report recommendations

- 2.76 The Committee notes the ANAO finding that the recommendations made in its previous audit of the design and conduct of RDAF round one, as agreed by the department, had 'not been implemented by the department'.¹¹⁸ DIRD's differing view regarding the department's

113 Mr McPhee, ANAO, *Committee Hansard*, Canberra, 6 March 2015, p. 19. See also ANAO, *Submission 2.1*, p. 2.

114 ANAO, *Implementing Better Practice Grants Administration*, Better Practice Guide, December 2013, p. 94 – quoted in ANAO, *Submission 2.1*, pp. 2-3; and *Commonwealth Grants Rules and Guidelines*, July 2014, paragraph 13.9, p. 35 – quoted in *Submission 2.1*, p. 3.

115 *Commonwealth Grants Rules and Guidelines*, July 2014, paragraph 13.9, p. 35 – quoted in ANAO, *Submission 2.1*, p. 3.

116 ANAO, Audit Report No. 9 (2014-15), pp. 150-151.

117 Mr Boyd, ANAO, *Committee Hansard*, Canberra, 6 March 2015, p. 19.

118 ANAO, Audit Report No. 9 (2014-15), p. 16.

progress in implementing these recommendations is noted.¹¹⁹ However, the Committee agrees with the Auditor-General that closer adherence to implementing ANAO recommendations – which often reflect ANAO’s experience of practices other departments have found to be beneficial – warrants ‘greater attention by the department’.¹²⁰

- 2.77 Accordingly, the Committee was pleased to note DIRD’s progress in implementing the recommendations from the ANAO report on RDAF rounds three and four, as outlined at the public hearing.¹²¹
- 2.78 The Committee supports the ANAO’s recommendations from the current and previous RDAF audits to improve the effectiveness of DIRD’s grants administration. Implementation of audit recommendations has been an ongoing focus of the ANAO and JCPAA.¹²² The Committee believes it would be useful for the ANAO to consider prioritising DIRD (or, as applicable, the department responsible for administering the regional portfolio) in its continuing series of audits of agencies’ implementation of performance audit recommendations.

Recommendation 1

- 2.79 **The Committee recommends that the Australian National Audit Office consider prioritising the Department of Infrastructure and Regional Development – or, as applicable, the department responsible for administering the regional portfolio – in its continuing series of audits of agencies’ implementation of performance audit recommendations.**

Better practice regional grants administration

- 2.80 The ANAO has undertaken performance audits of ‘each of the major regional grant funding programs introduced by successive governments over the last eleven years’.¹²³ The Committee was pleased to hear that, over this period, ‘improvements have been observed in some important aspects

119 See DIRD, *Submission 1*, p. 1. DIRD provided further details on how it had implemented these recommendations – see Ms O’Connell, DIRD, *Committee Hansard*, Canberra, 6 March 2015, p. 2; and *Submission 1*, pp. 2-3.

120 Mr McPhee, ANAO, ‘Opening statement’, *Submission 2*, p. 4.

121 Ms O’Connell, DIRD, *Committee Hansard*, Canberra, 6 March 2015, p. 1.

122 See, for example, ANAO, Audit Report No. 53 (2012-13), *Agencies’ Implementation of Performance Audit Recommendations*; and JCPAA, ‘Chapter 2: Defence’s implementation of audit recommendations’ and ‘Chapter 3: Agencies’ implementation of audit recommendations’ in *Report 443: Review of Auditor-General’s Reports Nos. 23 and 25 (2012-13) and 32 (2012-13) to 9 (2013-14)*.

123 ANAO, Audit Report No. 9 (2014-15), pp. 19-20.

of the design and implementation of regional grant programs'.¹²⁴ However, the Committee notes the ANAO finding that, in this context, the 'most important message from this audit is that considerable work remains to be done to design and conduct regional grant programs in a way where funding is awarded, and can be seen to have been awarded, to those applications that demonstrate the greatest merit in terms of the published program guidelines'.¹²⁵

2.81 Noting these continuing concerns in achieving better practice regional grants administration, the Committee believes that further improvement in this area might best be achieved through a range of approaches, including:

- Priority follow-up audits of the effectiveness of DIRD's grants administration, with a standing audit focus on regional grants administration
- Revision of the Commonwealth Grants Rules and Guidelines and ANAO Better Practice Guide, *Implementing Better Practice Grants Administration*, by the Department of Finance and the ANAO, as required, to reflect findings and recommendations of ANAO performance audit reports and JCPAA reports relevant to this area
- Priority ANAO follow-up of DIRD's implementation of audit recommendations
- Addition of a new section on 'Regional grants administration' in the ANAO Better Practice Guide, *Implementing Better Practice Grants Administration*
- An increased focus on training of departmental officers in this area, as required, by the Department of Finance

2.82 The Committee commends the Department of Finance and the ANAO on the development of the Commonwealth Grants Rules and Guidelines and the Better Practice Guide, *Implementing Better Practice Grants Administration*. The ANAO's Better Practice Guide is an important document in bringing together collective experience on this matter. As DIRD remarked at the public hearing, the guide is a 'particularly seminal and useful document to point out the way that the ANAO thinks that grants are best administered'.¹²⁶

124 ANAO, Audit Report No. 9 (2014-15), p. 20.

125 ANAO, Audit Report No. 9 (2014-15), p. 21.

126 Ms O'Connell, DIRD, *Committee Hansard*, Canberra, 6 March 2015, p. 10.

Recommendation 2

- 2.83 The Committee recommends that in the next update of its Better Practice Guide, *Implementing Better Practice Grants Administration*, the Australian National Audit Office (ANAO) consider incorporating a new section on 'Regional grants administration', focusing on the findings of recent ANAO reports on this area and the Committee's report, to maintain an emphasis on increased effectiveness in regional grants administration.

Recommendation 3

- 2.84 The Committee recommends that the Department of Finance, in consultation with the Australian National Audit Office (ANAO), update, as required, the Commonwealth Grants Rules and Guidelines to reflect recent ANAO audit findings concerning departmental grants administration, including further reinforcing the requirement for decision-makers to record the basis for funding decisions.
- 2.85 The Committee commends the ANAO for its continuing focus on auditing regional grants programs and notes the Auditor-General's salient point about the 'long-term gain' from such audit processes and the responses by the department over time.¹²⁷
- 2.86 The Committee was pleased to note DIRD's assurance that in designing the new National Stronger Regions Fund (NSRF) the department has 'taken into account the ANAO's recommendations and adjusted the way that program will operate accordingly'.¹²⁸ The Committee is aware that the design and implementation of the NSRF, including the processes by which projects are awarded funding, is listed as a potential audit in the ANAO's 2014 Audit Work Program.¹²⁹
- 2.87 The Committee notes the Auditor-General's conclusion that closer adherence to relevant aspects of the grants administration framework is a matter that warrants 'greater attention by the department',¹³⁰ and that 'considerable work remains to be done to design and conduct regional grant programs in a way where funding is awarded, and can be seen to

127 Mr McPhee, ANAO, *Committee Hansard*, Canberra, 6 March 2015, p. 23.

128 Mr Jaggars, DIRD, *Committee Hansard*, Canberra, 6 March 2015, p. 15.

129 ANAO, *Audit Work Program*, July 2014, p. 90.

130 Mr McPhee, ANAO, 'Opening statement', *Submission 2*, p. 4.

have been awarded, to those applications that demonstrate the greatest merit in terms of the published program guidelines'.¹³¹

- 2.88 Accordingly, the Committee believes there would be merit in the ANAO conducting priority follow-up audits of the effectiveness of DIRD's grants administration, and also adopting a standing priority audit focus on the design and conduct of future regional grants programs, to ensure a continued emphasis on effectiveness in this area. These audits could also usefully consider the effectiveness of the department's ongoing implementation of relevant ANAO recommendations.

Recommendation 4

- 2.89 **To encourage better practice grants administration, particularly concerning regional grants programs, the Committee recommends that the Australian National Audit Office (ANAO) consider including in its schedule of performance audits:**
- **priority follow-up audits of the effectiveness of grants program administration by the Department of Infrastructure and Regional Development**
 - **a standing priority audit focus on regional grants administration by the relevant department (with the specific timing of such audits as determined by the ANAO), noting that a potential performance audit of the design and implementation of the National Stronger Regions Fund is included in the ANAO's current forward Audit Work Program**

131 ANAO, Audit Report No. 9 (2014-15), p. 21.

Performance Audit No. 19 (2014-15)

Disposal of Specialist Military Equipment

Introduction

- 3.1 Chapter 3 discusses the Joint Committee of Public Accounts and Audit (JCPAA) review of the Australian National Audit Office ANAO Report No. 19 (2014–15), *Management of the Disposal of Specialist Military Equipment*. The chapter comprises:
- an overview of the report, including the audit objective, scope and audit conclusion
 - Committee review
 - Committee comment

Report overview

- 3.2 Defence manages Commonwealth assets worth some \$75 billion, over half of which comprise specialist military equipment (SME) – including ships, vehicles and aircraft. Each type of SME must be managed through its life cycle, including disposal. Disposal can include re-use within Defence for a different purpose, including for heritage or display, as well as transfer, sale, gifting or destruction. SME disposed of in recent years includes:
- the Royal Australian Navy's (RAN's) frigates HMA Ships *Canberra* and *Adelaide*, which were scuttled as dive wrecks, but at unexpectedly high cost

- the Army's fleet of Leopard 1AS tanks, most of which were retained or gifted for display
 - the Royal Australian Air Force's (RAAF's) F-111C/G long-range strike aircraft, a few of which were retained for display but most of which were destroyed because of asbestos content.¹
- 3.3 Proceeds from SME disposals can vary significantly. Proceeds were \$12.5m in 2012–13 and \$49.4m in 2013–14. Defence disposal activity is expected to increase in the medium term due to Defence's major program of upgrading and replacing SME over the next 15 years.²
- 3.4 Managing SME disposals requires an understanding of possible markets for the surplus equipment. It also requires Defence to consider:
- international obligations, particularly relating to demilitarisation and technology of United States (US) origin;
 - Australian obligations relating to the management of hazardous substances, such as asbestos;
 - environmental protection; and
 - the resource management framework applying to government entities.³
- 3.5 Disposing of SME is therefore a complex task, whether achieved through re-use, retention for heritage or display, gifting, sale or destruction. Disposal risks include the potential for excessive and unanticipated costs, stakeholder dissatisfaction, and loss of reputation should the equipment pass into the wrong hands.⁴
- 3.6 Under this audit, the primary legislation governing disposal of Commonwealth assets was the *Financial Management and Accountability Act 1997 (FMA Act)*⁵. Under the FMA framework, Defence's internal instructions imposed an obligation on staff managing disposals to optimise the outcome for the Commonwealth in each case, having regard to:
- legal, contractual, government and international requirements;
 - ensuring that actions would withstand scrutiny;
 - being fair, open and honest; and

1 ANAO Report No. 19 (2014–15), *Management of the Disposal of Specialist Military Equipment*, p. 11.

2 ANAO Report No. 19 (2014–15), p. 11.

3 ANAO Report No. 19 (2014–15), p. 11.

4 ANAO Report No. 19 (2014–15), p. 11.

5 On 1 July 2014, the *Public Governance, Performance and Accountability Act 2013* replaced the FMA Act

- considering the cultural, historical and environmental significance of providing the item to appropriate organisations.⁶
- 3.7 The Defence Materiel Organisation (DMO)⁷ has overall responsibility for disposal of SME on behalf of Defence in conjunction with the Capability Manager, and the function is now co-ordinated by the Australian Military Sales Office (AMSO) in DMO's Defence Industry Division. However, many parts of Defence may have an interest in any particular disposal.⁸

ANAO Audit objective and scope

- 3.8 The Secretary of Defence and Chief of the Defence Force (CDF) wrote to the Auditor-General in April 2013 and requested a performance audit of Defence's management of SME disposals. In May 2013, the Auditor-General agreed. The audit objective was to assess the effectiveness of Defence's management of the disposal of SME. The audit considered:
- whether Defence has conducted disposals in accordance with applicable Commonwealth legislative and policy requirements and Defence policies, guidelines and instructions; and
 - where relevant rules have been departed from, the main reasons and consequences. The audit examined Defence records of selected disposals that occurred over the last 15 years, especially the period from 2005 to 2013, including actions in response to disposals not proceeding as intended.⁹
- 3.9 The high-level criteria developed to assist in evaluating Defence's performance were:
- Defence policies and procedures governing disposals comply with relevant Commonwealth legislation and policy;
 - Defence disposal of SME is carried out effectively, in accordance with relevant legislation, policies and instructions; and
 - recent reforms in the management of Defence disposals are suitably designed and progressing effectively.¹⁰

6 ANAO Report No. 19 (2014–15), p. 12.

7 In April 2015, the Minister for Defence, the Hon Kevin Andrews, announced a series of reforms for the Department of Defence. One of the reforms announced through the *First Principles Review: Creating One Defence* policy paper was the abolition of the DMO and the return of its functions to the broader Department of Defence.

8 ANAO Report No. 19 (2014–15), p. 12.

9 ANAO Report No. 19 (2014–15), p. 13.

10 ANAO Report No. 19 (2014–15), p. 13.

ANAO overall conclusion

- 3.10 Disposal of SME is complex and often time-consuming, and can give rise to financial and reputational risks for Defence and the Australian Government. To be effective, SME disposals require a balanced assessment of risks and potential benefits with appropriate senior leadership attention within Defence. The ANAO found that Defence's management of SME disposals has not been to the standard expected as insufficient attention was devoted to:
- achieving the best outcome for the Australian Government;
 - reputational and other risks that arise in disposing of SME;
 - managing hazardous substances; and
 - adhering to Commonwealth legislation and policy for gifting public assets.¹¹
- 3.11 The ANAO found that the major disposals examined had been largely disappointing as they have generally taken a long time, incurred substantial and unanticipated costs, and incurred risks to Defence's reputation. This includes:
- the disposal of RAN ships has proven expensive and, where they have been gifted for use as dive wrecks, costly to the RAN's sustainment budget;
 - the Army B Vehicles¹² disposal was arranged through a request-for-tender, and the adequacy of the tender evaluation process has been questioned by internal and external advisers to Defence;
 - the Boeing 707 aircraft disposal has been prolonged, involved, and yielded much less than the original contracted sale price; and
 - the Caribou aircraft disposal is ongoing after five years following a flawed tender process and uncertainty as to the identity and business of the major purchaser.¹³
- 3.12 Boeing 707 and Caribou aircraft disposal problems were already known to Defence and led the Secretary and CDF to request this audit. The audit highlighted a number of consistent underlying themes in the difficulties in managing SME disposals. The key issues were:
- a disproportionate focus on revenue without full regard to costs;
 - insufficient attention to risk management;
 - the quality of internal guidance;
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11 ANAO Report No. 19 (2014–15), p. 13.

12 B Vehicles comprise about 12,000 Army trucks, trailers and four and six-wheel drives, which are beyond their expected operating life. ANAO Report No. 19 (2014–15), p. 21.

13 ANAO Report No. 19 (2014–15), p. 14.

- fragmented responsibilities; and
 - limited senior management engagement.¹⁴
- 3.13 The ANAO found that Defence's rules were not clear or fully developed for SME disposals, despite many internal sources of guidance. In particular, Defence lacked a set of operational procedures for SME disposals and clearly identify roles and responsibilities across the large number of Defence stakeholders. Thus, Defence staff had limited guidance on key issues such as the potential costs of disposal activity, and there was no requirement to check on the capacity of the entities with whom Defence was dealing.¹⁵
- 3.14 The ANAO commented that shortcomings in Defence guidance relating to establishing the bona fides of third parties contributed to increased risks to the Commonwealth's reputation. Further, some of Defence's internal rules – relating to gifting of assets – did not correctly reflect the long-standing requirements of the Australian Government's resource management framework which introduced risks of inappropriate or incorrect gifting of surplus Defence SME.¹⁶
- 3.15 While the reform of SME disposals has been attempted in recent years, it had not consistently held the attention of Defence's senior leadership. The ANAO concluded that reforms that commenced in 2011 had good intentions but were not supported by sufficient analysis and were based on a flawed assessment of the prospect for making SME disposals into a net revenue-generating program.
- [Defence] was almost certainly over-optimistic in this objective, and underplayed the importance of adopting a balanced approach to managing risks. The initiative lacked ongoing senior leadership involvement and no arrangements were made to monitor and report on its progress. It appears now to have fallen away without tangible results.¹⁷
- 3.16 The ANAO found that history indicates that Defence staff tend to focus on the apparent revenue available from equipment sales without full regard to the risks taken in pursuit of that revenue. Risks included reputational risks and risks of further costs being incurred during the disposal process. As discussed in the audit report, reforms in 2011 highlighted the gaining of revenue as an objective for SME disposals.

14 ANAO Report No. 19 (2014–15), p. 14.

15 ANAO Report No. 19 (2014–15), p. 14.

16 ANAO Report No. 19 (2014–15), p. 14.

17 ANAO Report No. 19 (2014–15), p. 15.

Once the reform program had been announced, there was a tendency at the operational level to focus on maximising the revenue from each disposal transaction with much less attention to the costs incurred. As the audit shows, the costs to Defence can exceed the potential revenue available.¹⁸

- 3.17 A major challenge had been the presence of asbestos in SME. Defence set about a vigorous remediation program to remove asbestos from its workplaces. Defence also resolved in late 2009, through a VCDF directive, that items containing asbestos should be disposed of by sale or gift only where any asbestos contained within the item could not be accessed by future users, and as such would not pose a health risk to those future users. However, the audit identified instances where the costs of identifying and removing asbestos from items being disposed of, and the prospect of greater disposal revenue, led Defence to dispose of items that may have contained accessible asbestos without full regard to the management of the risks or transparent declaration of those risks to potential purchasers.¹⁹
- 3.18 The ANAO reported that the Defence Minister does not hold the formal decision-making authority for gifting Commonwealth assets. The Australian Government's resource management framework states that the Finance Minister has that authority and has delegated it to the Secretary of Defence. The ANAO commented that a challenge remained for Defence to develop early advice to ministers about the requirements and operation of the gifting delegation where any options for gifting are to be contemplated.²⁰
- 3.19 The audit's key message was that decision-making should be based on a broader understanding of the benefits, risks and costs of each disposal. Officials performing the disposals function need to have regard to the full picture, weighing up potential revenue against the cost of disposal action and the range of potential risks to Defence and the Australian Government. The ANAO stated:

The effective assessment and treatment of risks often requires experience and must be afforded higher priority within the Defence Organisation, including through senior leadership attention at key points in the disposal process for more sensitive items. Those who are assigned management responsibility for an SME disposal should be expected to develop the necessary breadth

18 ANAO Report No. 19 (2014-15), p. 15.

19 ANAO Report No. 19 (2014-15), pp. 15-16.

20 ANAO Report No. 19 (2014-15), p. 16

of understanding and be well placed to complete the disposal efficiently, effectively and properly.²¹

Audit recommendations and agency response

3.20 The ANAO made five recommendations aimed at strengthening Defence's SME disposals framework and practice. Table 3.1 sets out the recommendations for ANAO Report No. 19 and Defence's response.²²

Table 3.1 ANAO recommendations, Report No. 19 (2014-15)

1	<p>To rationalise and simplify its existing framework of rules and guidelines for disposal of specialist military equipment, the ANAO recommends that Defence:</p> <ul style="list-style-type: none"> (a) review and consolidate relevant existing guidance with a view to ensuring that it is concise, complete and correct; and (b) consult the Department of Finance in the course of this review, to maintain alignment with the wider resource management framework. <p>Defence response: <i>Agreed.</i></p> <p>Finance response: <i>Supported</i></p>
2	<p>The ANAO recommends that, to improve the future management of the disposal of Defence specialist military equipment, Defence identifies, for each major disposal, a project manager with the authority, access to funding through appropriate protocols and responsibility for completing that disposal in accordance with Defence guidance and requirements.</p> <p>Defence response: <i>Agreed</i></p>
3	<p>The ANAO recommends that, to improve the future management of the disposal of Defence specialist military equipment, Defence puts in place the arrangements necessary to identify all significant costs it incurs in each such disposal (including personnel costs, the costs of internal and external legal advice, management of unique spares and so on), and reports on these costs after each such disposal.</p> <p>Defence response: <i>Agreed</i></p>
4	<p>To bring its instructions and guidelines that address gifting of Defence assets into alignment with the requirements of the resource management framework, the ANAO recommends that Defence promptly review all such material. This could be undertaken as part of the review recommended in Recommendation No. 1.</p> <p>Defence response: <i>Agreed</i></p>
5	<p>The ANAO recommends that Defence:</p> <ul style="list-style-type: none"> (a) reinforce its conflict of interest and post-separation policies to all ADF members and APS staff, particularly in relation

21 ANAO Report No. 19 (2014-15), p. 16.

22 ANAO Report No. 19 (2014-15), pp. 29-30.

to future private sector and Defence Reservist employment; and

- (b) introduce practical measures to achieve consistent application of the policies across the Defence Organisation.

Defence response: Agreed

3.21 Defence provided the following response to the audit report:

Following a request from the Secretary of Defence and the Chief of the Defence Force to the Auditor-General in April 2013, Defence thanks the Auditor-General for recognising concerns around the management of major equipment disposal.

Defence welcomes the thoroughness of the review and agrees with the recommendations that will help to improve Defence's governance around disposal management.

Defence acknowledges that the disposal of military assets is an area of concern and that this important aspect of asset management appears to have not had the same level of attention relative to higher profile acquisition, sustainment and operational activities. Defence appreciates the analysis provided by ANAO and will undertake to address the shortcomings in policy and performance.

The audit has highlighted the broad range of issues that must be considered in planning for disposal of major equipments. The audit report indicates that Defence does, for the most part, address the majority of these considerations, but that policy and guidance has been deficient which leads to the difficulty in achieving consistently high standards across the wide range of disposal types.

The report includes a chapter on the treatment of hazardous materials and draws attention to Defence's handling of asbestos containing material through the disposal process. Defence seeks to ensure that all hazardous materials are properly considered and managed, and that it complies with all of its legal obligations, when undertaking the disposal of Defence equipment.

Defence considers that the chapter overstates the risk associated with non-friable forms of asbestos that might still be in equipment subject to disposal. Defence considers the residual risk posed by exposure to asbestos in the B-vehicles is no greater than that inherent in a wide range of vehicles of similar vintage which are also still saleable. However, Defence has taken steps to address the concerns raised in this report. Specifically, Defence has delayed the B-vehicles disposals to allow time to ensure

Defence's asbestos management policies are both responsible and pragmatic.

The report validates Defence's concerns regarding cost implications for the Commonwealth and the potential for future liability arising from gifting of Defence assets, albeit with positive intent.

This report also rightly serves to remind Defence that there are broader considerations other than revenue that are important to the Commonwealth when planning the disposal of specialist military equipment.²³

- 3.22 The ANAO also sent extracts from the proposed report to the Department of Finance (Finance) and to three commercial parties whom the ANAO considered had a special interest in the content of those extracts.²⁴

Committee review

- 3.23 Representatives of the following agencies gave evidence at the Committee's public hearing on 14 May 2015:
- Defence Materiel Organisation (DMO)
 - Department of Defence
 - Australian National Audit Office (ANAO)
- 3.24 As discussed below, the Committee focussed on the following issues during its review of the ANAO's report:
- Redress of issues raised in the ANAO report
 - Disposal of decommissioned warships
 - Disposal of specialist military equipment in operational areas
 - Caribou aircraft
 - Disposal of Sandline helicopters
 - Financial delegations
 - Conflicts of interest
 - Staff training and corporate knowledge

Redress of issues raised in the ANAO report

- 3.25 The Department of Defence, having itself requested the audit of SME disposals, has already begun to institute reforms that address the issues

23 ANAO Report No. 19 (2014–15), pp. 27–28.

24 ANAO Report No. 19 (2014–15), p. 28.

raised in the ANAO report. Defence responded that senior management oversight and attention is now firmly placed on the area of disposals, and they are systematically working through all the issues identified by the Auditor-General's report.²⁵

- 3.26 First, major disposals are now being led by a single area in Defence, which is the Australian Military Sales Office (AMSO). Defence claim they are also developing a consolidated, streamlined and simplified policy framework, and are undertaking a whole of Defence review of disposals policy.²⁶ Defence explained:

We have gone through the [ANAO] audit report and identified many, many other areas that we need to address. It is probably fair to say, and as the ANAO report also identifies, that we had conducted an independent review at the end of 2013 which had identified a number of gaps in terms of policies and procedures. We were working through a number of those gaps while the audit was ongoing and we have now systematically categorised them. We have categorised it into governance, which is the level of oversight the organisation has. We have also categorised it into policies and procedures, which includes new templates. We have also categorised it into checklists, which include for example the risk relating to *bona fides* and getting our inspector-general organisation to do an assessment. We have also categorised it into education and training for staff, and so on and so on. In addition to the management response to the five recommendations internally, we have a suite of recommendations and initiatives under each of those headings that we are working through.²⁷

- 3.27 Second, Defence has also initiated its own audit processes to complement those of the ANAO:

The audit area within Defence has also done a review on disposals as well and we have some recommendations we are working through with them. To close the actual recommendations the area needs to submit to my area a detailed explanation of what has been done and we will then go and inspect that to see if not just the finding itself, the recommendation, has been closed but the

25 Mr Harry Dunstall, Acting Chief Executive Officer, Defence Materiel Organisation, Department of Defence, *Committee Hansard*, 14 May 2015, p. 2.

26 Mr Harry Dunstall, Acting Chief Executive Officer, Defence Materiel Organisation, Department of Defence, *Committee Hansard*, 14 May 2015, p. 2.

27 Ms Michelle Kelly, Head, Defence Industry, Department of Defence, *Committee Hansard*, 14 May 2015, p. 10.

intent of the issue has also been met. This builds a high level of confidence that whatever has been done will become enduring.²⁸

- 3.28 Finally, in terms of some of the specific issues raised in the ANAO report, such as disposal of assets contaminated with asbestos and B type vehicles, some particular initiatives have been developed:

The ANAO report identified that Defence has not always adhered to the internal guidance on disposal of assets containing asbestos. We have reviewed the guidance and a new framework has been implemented, and I worked with the Vice Chief of the Defence Force to issue an updated instruction on disposal of assets containing asbestos... We are now also undertaking a comprehensive work health and safety risk assessment for each disposal, and that is being used to determine the most practicable remediation action – it is not only for asbestos but all hazardous material.

[I]n relation to the B vehicles, we had already taken a number of steps... to suspend the supply of B vehicles to the sales contractor and at our request the contractor, Australian National Disposals, cancelled the auctions planned for January and February while we put in place updated measures. We have disclosed all relevant safety related information to the contractor, who has in turn passed those onto past and future purchasers. We have got a dedicated website set up, to allow easy public access to safety and hazardous substance documentation. We have also asked the contractor, and they have done this, to produce a number of warning labels regarding potential asbestos content; those labels have been posted to all past purchasers. For vehicles not sold, the warning labels are now being affixed to the vehicles before they are on-sold... [T]he company has now restarted the public auctions, and those started in March 2015.²⁹

Disposal of decommissioned warships

- 3.29 The disposal of decommissioned Australian warships featured in the ANAO report, notably the *HMAS Adelaide* and *HMAS Canberra* – both Adelaide class frigates. *HMAS Sydney* – also an Adelaide class frigate – is

28 Mr Geoffrey Brown, Chief Audit Executive, Department of Defence, *Committee Hansard*, 14 May 2015, p 10.

29 Mr Harry Dunstall, Acting Chief Executive Officer, Defence Materiel Organisation, Department of Defence, *Committee Hansard*, 14 May 2015, p. 2.

also scheduled to be decommissioned at the end of 2015.³⁰ Given the issues with the earlier two warships, the Committee was interested in what had been learned and how this would apply to the decommissioning of *HMAS Sydney*. Defence responded that the ANAO's recommendations had resulted in changes to disposal process and gave the upcoming decommissioning of *HMAS Tobruk* as an example of the new approach Defence is taking:

HMAS Tobruk is a good example because it is being decommissioned about the middle of this year. Already we have received... a number of representations from various areas around Australia for a range of things, including sinking it as a dive wreck, and parts going to various heritage organisations. So for this one we have reinstated a governance framework which goes to what the ANAO identified, which was that disposal is managed in a whole range of different areas in Defence and not consolidated under one governance framework, and there is not a clear accountability in terms of responsibility.

We have readjusted that accountability framework so there is one area that brings in all stakeholders, who discuss and make recommendations in terms of disposal strategies. That area also has responsibility for ticking-off on a range of WHS [Work Health and Safety] risks, hazardous substances, security, probity – all of the issues that are in our checklist that are similar to our acquisition processes that need to be cleared. This was in direct response to another ANAO concern, which was that there was not sufficient senior level oversight not only in terms of disposal decisions, but also to make sure that there was sufficient compliance in terms of the process. It also now has sufficient oversight within the Defence Materiel Organisation before it goes to the relevant capability manager, who is the delegate, and before it goes to the minister for his review.³¹

3.30 New workplace health and safety laws have made disposing of decommissioned warships as dive-wrecks increasingly complicated and difficult. Defence explained:

The legislation has changed quite significantly. In terms of the states, as you are aware and as is outlined in the report quite

30 "Final entry into Sydney for city's namesake warship", *Media Release*, Department of Defence, 27 February 2015, <<http://news.defence.gov.au/2015/02/27/final-entry-into-sydney-for-citys-namesake-warship/>> accessed 25 May 2015.

31 Ms Michelle Kelly, Head, Defence Industry, Department of Defence, *Committee Hansard*, 14 May 2015, p. 3.

extensively, there were issues associated with the states being able to pay the full amount of the cost. Defence ended up incurring quite significant costs over and above what was expected. In terms of the state issue, we have certainly looked at thinking about how, going forward, should we ever do a dive wreck, we can put in place arrangements to ensure that the states can pay and can comply with WHS and hazardous material requirements.

Having said that, the bigger issue for us at the moment is really the constraints that WHS puts on agreeing to a dive wreck at all. That in the case of [HMAS] *Tobruk* is something that we are working through in terms of expert WHS advisers and with ministers' offices and other stakeholders to work out how we can manage it. Once we cross that threshold – if we can – we will need to put in place much more rigorous arrangements with states. Now not only is the cost an issue for them; but WHS is even more so an issue for them not only now but years down the track.³²

- 3.31 Defence was asked if effective processes had been established to ensure that commitments from state governments were being followed through. Defence explained that the difficulties were more to do with the Work Health and Safety risks and the increased costs those risks entailed:

We had agreements in place with the states at the time. Once the additional cost became apparent, the states were not willing to fund those costs. But we cannot outsource our obligations to ensure that, if a ship is used as a dive wreck, it is sunk safely, that all work health and safety issues are taken into account. So, ultimately, we still have a residual liability to ensure that it is done safely. While we can certainly deal with the financial consequences through revisions to the agreement and requiring money to be paid up-front.... I think the greater challenge for us is to ensure that, if a state does take it and we have agreed for a ship to be used as a dive wreck, it is actually sunk safely and all the work health and safety issues are dealt with. I think the advice we have received is that we would always have some level of residual liability to an individual should they suffer harm as a result of a matter relating to that dive wreck.³³

32 Ms Michelle Kelly, Head, Defence Industry, Department of Defence, *Committee Hansard*, 14 May 2015, pp. 4-5.

33 Mr Harry Dunstall, Acting Chief Executive Officer, Defence Materiel Organisation, Department of Defence, *Committee Hansard*, 14 May 2015, p. 5.

Disposal of specialist military equipment in operational areas

- 3.32 By coincidence members of the JCPAA visited Afghanistan in 2014 and witnessed the Mine-Resistant Ambush Protected (MRAP) vehicles being compacted and destroyed. Although the MRAPs were not at 'end-of-life' and still serviceable, they were surplus to requirements and the costs of return to Australia were deemed prohibitive following a cost-benefit analysis of that disposal option.³⁴ Defence explained the process for disposal of assets in theatre and/or overseas:

An assessment is taken of the costs, benefits and risks of the various disposal strategies – for example, we would look at whether we want to repatriate the equipment to Australia, whether it can continue to be used, whether it has a life, and then the ongoing sustainment costs of those and the cost to remediate. We would have a look at requests by the relevant country for retention of particular capability, and then we would also assess the risks around doing that, depending on the nature of the capability. We would have a look at what the best method of disposal is, whether that is sale or gift to the country. We would normally seek assurances around how that equipment would be maintained. We would do an assessment. Does the country have the capacity to support that equipment? What will be the expectation on spares and supply chain and our ongoing liability? Those are issues we would look at – either sale or gift to the country, bringing back to Australia for either retention remediation and further use, or some other disposal activity. Another option would be simply to dispose of it where it is in theatre. All those considerations are taken into account before we make a decision about what the best disposal action is.³⁵

Caribou aircraft

- 3.33 Although it was known the Caribou aircraft contained asbestos, the decision was made to gift some of them to historical societies and museums. Defence was asked to provide further explanation as to why and how this occurred and the current status of the aircraft and any possible remediation work:

The asbestos is in situ. A number of old military platforms contain asbestos. For example, the Leopard tanks, which were also gifted,

34 Mr Harry Dunstall, Acting Chief Executive Officer, Defence Materiel Organisation, Department of Defence, *Committee Hansard*, 14 May 2015, pp. 3-4.

35 Mr Harry Dunstall, Acting Chief Executive Officer, Defence Materiel Organisation, Department of Defence, *Committee Hansard*, 14 May 2015, p. 3.

contain asbestos. This is part of our assessment when we are looking at a disposal strategy.³⁶

It is a slightly different case for those particular Caribou. There is an ongoing monitoring program for those particular ones. It is slightly different to the tanks, for example, which we have welded up so that they are not accessible³⁷...What we normally do is have a program in place to make sure that, in the case of Leopard tanks, they were welded up so that the asbestos is not accessible.³⁸

[W]e have two [Caribou] aircraft in flying condition that are being maintained by the heritage organisations concerned. We have a detailed plan in place to ensure they are maintained in an appropriate way to ensure they are safe... But obviously we would not be allowing those to be flying if the asbestos was not being safely managed.³⁹

Disposal of Sandline helicopters

- 3.34 The ANAO report identified the case of two Russian-made Mi-24 'Hind' attack helicopters that came to Australia as part of a shipment of military equipment in 1997. A United Kingdom-based private military company, Sandline International (Sandline), had assembled the equipment for use under contract to the Papua New Guinea Government. However, changed circumstances led to the equipment being brought to Australia aboard a Russian Antonov transport aircraft, which landed at Tindal RAAF base.
- 3.35 Originally regarded by Air Force as 'a matter for Customs', the equipment included four helicopters, two of which were regarded as civilian and later sold, and two Mi-24 attack helicopters. In February 2002, the attention of Parliament was brought to the continued presence of the two Mi-24 helicopters. The then Minister for Defence advised a Senate Estimates hearing that they were 'in limbo' but, when asked on how long they would remain so, he indicated that he was not contemplating a period of 10 or 20 years. In 2014, seventeen years after their arrival, the helicopters remained at Tindal.⁴⁰

36 Mr Harry Dunstall, Acting Chief Executive Officer, Defence Materiel Organisation, Department of Defence, *Committee Hansard*, 14 May 2015, p. 6.

37 Ms Michelle Kelly, Head, Defence Industry, Department of Defence, *Committee Hansard*, 14 May 2015, p. 6.

38 Ms Michelle Kelly, Head, Defence Industry, Department of Defence, *Committee Hansard*, 14 May 2015, p. 6.

39 Mr Harry Dunstall, Acting Chief Executive Officer, Defence Materiel Organisation, Department of Defence, *Committee Hansard*, 14 May 2015, pp. 6-7.

40 ANAO Report No. 19 (2014-15), p. 198

- 3.36 The continued storage at Tindal of these military attack helicopters has resulted in Defence incurring an unquantified cost for the better part of two decades.⁴¹ When asked for an update, Defence explained that while the aircraft are still expected to be disposed of within 12 months, there have been further delays:

The particular equipment in question is not ours but...we are going through that process and I expect that to be complete inside the next 12 months. We have had some trip-ups along the way, particularly related to disposal and access during the wet season. But I expect that to be complete in the next 12 months. The [ANAO] audit report talks about specific dates and briefs to the minister. That has not occurred. It did not occur in January because the particular request that was made, as referred to in the report, was withdrawn. So advice to the minister at that time would have been incomplete. I expect that advice to be updated later this year.⁴²

Financial delegations

- 3.37 The issue of who has the financial delegation to gift former military assets as evidenced by the report engaged the Committee's interest, especially as the items gifted are usually of high-dollar value. Committee members asked for clarification on the process and lines of responsibility.
- 3.38 Regarding the dive-wrecks, and the advice given by DMO to the Defence Minister, Defence responded:

I think it is partially a semantic issue, partially not a semantic issue. For disposals of those kinds of assets we would always seek a ministerial view around what the disposal options would be. I think that from a timing perspective we could have been better at advising the minister up-front around what the rules around gifting were and that it is actually an internal delegates decision, then having the minister approach the finance minister for confirmation of the strategy prior to them making the offer. So I think it is a timing issue. We probably could have been better at advising the minister up-front about what the actual process was and who the delegates were.⁴³

41 ANAO Report No. 19 (2014–15), p. 27.

42 Air Commodore Peter Yates, Director, General Logistics – Air Force, Department of Defence, *Committee Hansard*, 14 May 2015, p. 9.

43 Mr Harry Dunstall, Acting Chief Executive Officer, Defence Materiel Organisation, Department of Defence, *Committee Hansard*, 14 May 2015, p. 3.

- 3.39 Defence made it clear that the Minister for Finance has the delegation in terms of gifting of Commonwealth property, but that this was further delegated to chief executives which was then again delegated to service chiefs with the caveat that such delegations were limited to certain dollar values. Nonetheless, the Defence Minister is consulted on the various proposals.

The Minister for Finance has the delegation in terms of gifting of Commonwealth property. As I understand it, he has delegated that to chief executives, which are effectively the secretaries of departments. In our case it is the secretary and the CDF. It has been further devolved within the department down to the service chiefs as well, and I think their threshold is \$500,000. Anything above that in terms of value of the asset and the delegate is either the secretary or CDF.

While the finance minister has delegated it to the department that does not necessarily mean that we consult the finance minister because he has delegated that authority. But what we do quite properly do is engage with our ministers as the case is throughout the process, quite properly, to talk about the issues, the options, preferences, other aspects the delegate may need to take into account in exercising their delegation. So we consult with the minister and advise him... So we just need to be clear – and we will certainly be in the future – about where the delegation lies and what information and consultation it is we are actually seeking or having with ministers...

If it is a major disposal then the [Defence] minister might want to have a conversation with colleagues and take a broader government view. But, ultimately, the final decision is not the minister's; it is the delegate's.⁴⁴

- 3.40 Defence noted the ANAO report's conclusion with regard to financial delegation and advised they had altered their processes accordingly.

Conflicts of interest

- 3.41 Potential conflicts of interest were identified by the ANAO report which was of interest to the Committee – particularly as in one example 'there is no evidence that, at the time, any Defence staff identified...a perceived or

44 Ms Michelle Kelly, Head, Defence Industry, Department of Defence and Mr Harry Dunstall, Acting Chief Executive Officer, Defence Materiel Organisation, Department of Defence, *Committee Hansard*, 14 May 2015, p. 4.

actual conflict of interest.’⁴⁵ Defence explained what steps were being taken to address this issue:

[W]hen we do major procurements we have really strict processes. We have strict rules in our request for tenders and our evaluation plans. We appoint probity advisors. We seek conflict of interest declarations. As I was saying before, as part of our revised processes, what we are now applying to our disposal activity is the similar level of rigor to that we apply to our procurement processes – so, using consistent processes. Obviously, one is a procurement of something and one is a disposal, but to some extent there is commonality – similar request for tender, conditions of tender; similar provisions in contracts; similar requirements for an evaluation plan, for probity requirements in that plan; and so on... The other thing I would observe is that we paid a lot of attention in the DMO to post-separation employment and management of conflicts of interests... I think part of the problem with the post-separation is the inconsistent application across the broader defence organisation.

There is now a much more consistent approach across the defence organisation to managing, in particular, the post-separation issue, and also the use of reservists, because even in our major procurement processes we have come across some examples where people are coming in and doing reserve work, but who also work in their normal jobs for Defence contractors. There are challenges around managing that, because as a reservist they have access to the Defence network. They might have access to information that could be of assistance to that company in tender processes that are ongoing or forthcoming. So we have done a lot of work with each of the headquarters to make sure that they are adopting a similar approach to what we do in DMO in managing that post-separation conflict of interest.⁴⁶

3.42 A representative for the RAAF gave a practical example of how their service approached the issue:

Last year a member of my staff was resigning from Air Force and was seeking employment with a major contractor. We actually went through a formal investigation and declaration of conflict of interest. The policy requires me to send that to deputy chiefs. I sent it to the deputy chief. The deputy chief agreed with my

45 ANAO Report No. 19 (2014–15), p. 195.

46 Mr Harry Dunstall, Acting Chief Executive Officer, Defence Materiel Organisation, Department of Defence, *Committee Hansard*, 14 May 2015, pp. 8-9.

assessment that there was no real or perceived conflict of interest, and we have actually stored that advice. My view is that the revised procedures are in place. They are far better than they used to be, and we are able to use them to good effect. I cannot speak for all of Air Force – I only control one part of it – but certainly we are using those instructions.⁴⁷

Staff training and corporate knowledge

3.43 Failings by employees in the conduct of disposal of Defence SME, such as the inadequate advice regarding financial delegations, can in part be traced back to factors such as skills, experience, training and organisational structure. Defence provided an overview of the section now charged with disposals and its staffing arrangements:

We set up the Australian Military Sales Office a few years ago... The Australian Military Sales Office was set up from within the existing staffing that I had from both Defence Industry Division and Defence Disposal Agency. I merged some people from the Defence Industry Division with the Defence Disposal Agency to try to build a capability... We have also bolstered the commercial acumen; we also have a number of contracting folk in our organisation and our legal folk. We are paying a lot greater attention to the way we go about doing disposals by using the same skill sets, processes and templates as we do for a major procurement. I think the ANAO report identified that our focus has tended to be on the procurement of new capability, and disposals has been kind of the poor cousin. We are now trying to apply the same level of rigour, skill sets, process and best practice to the disposals operation that we do for procurement.⁴⁸

3.44 Staff turnover has been significant. When the Australian Military Sales Office (AMSO) was established in July 2012, it incorporated the existing Defence Disposals Agency which had 11 staff members. Seven of these staff members, including the director, have since left the AMSO.⁴⁹ Such a high staff turnover can undermine the retention of corporate knowledge and the execution of competent experience based risk analysis. Defence explained the manner in which it is addressing these issues:

47 Air Commodore Peter Yates, Director, General Logistics – Air Force, Department of Defence, *Committee Hansard*, 14 May 2015, p. 9.

48 Mr Harry Dunstall, Acting Chief Executive Officer, Defence Materiel Organisation, Department of Defence, *Committee Hansard*, 14 May 2015, p. 5.

49 *Submission 3*, Department of Defence, p. 3.

We have lots of training courses that we put our staff through. I think I mentioned before we have a significant contracting workforce that we apply to our procurements as well as in-house legal function and we have now mandated that disposals and military sales make use of that highly-skilled workforce in undertaking this work. They will identify the need for a risk assessment and we might then get external support to come in and help us with the risk assessment or we bring in other expertise from across the organisation to support us in that activity.⁵⁰

We have a quite well-matured risk assessment processes. We have a project risk management manual. We have a lot of guidance about how to undertake risk assessment in terms of project risk, capability risk and liability risk. I think one of the things that was identified by the ANAO report was that we had not been applying those mature processes and procedures and templates that we had from our procurement work to the disposals work. Again, that is something that we have brought across that we are now applying more rigorously when we are doing disposals and sales of military equipment.⁵¹

Committee comment

- 3.45 The Committee is encouraged by the fact that it was Defence itself that requested this ANAO audit having recognised that problems existed regarding disposal of SME.
- 3.46 Defence provided an enthusiastic overview of the reforms the department has instituted to address the concerns raised in the ANAO report. The Committee commends the ANAO recommendation that Defence rationalise and simplify the framework of rules and guidelines for disposal of SME. The Committee notes Defence's assurances it is developing a consolidated, streamlined and simplified framework on Defence disposals.
- 3.47 The conflicts of interests highlighted in the report are of concern to the Committee. Although Defence has outlined its reformed approach, the opportunity for such conflicts, either perceived or real, to occur, remains particularly when there are large dollar values involved. Reputational

50 Mr Harry Dunstall, Acting Chief Executive Officer, Defence Materiel Organisation, Department of Defence, *Committee Hansard*, 14 May 2015, p. 10.

51 Mr Harry Dunstall, Acting Chief Executive Officer, Defence Materiel Organisation, Department of Defence, *Committee Hansard*, 14 May 2015, p. 9.

issues for both Defence and the Australian Government may arise if cases such as those reviewed in the report continue and Defence must ensure that its internal processes eliminate such occurrences.

- 3.48 Although the Committee is encouraged by Defence's initiatives, one of the challenges will be that the enthusiasm currently being shown and the reforms currently being instituted result in long-term reform in the procedures and policies of SME disposal. However, the Committee is concerned that the *One Defence* reforms, that will result in DMO being folded back into the Department of Defence, may in some way undermine the improvements being made to the disposal of SME given that DMO has oversight of this function. To ensure that the current momentum and reform in this area is maintained, an initial follow-up audit should be considered within 12 months following the tabling of this report with the possibility of further audits in the future.

Recommendation 5

- 3.49 **The Committee recommends that the Australian National Audit Office (ANAO) consider a follow up audit 12 months following the tabling of this report to provide an update on the progress of Department of Defence's reforms with regard to the disposal of Specialist Military Equipment. Further audits in this area could be considered by the ANAO.**
- 3.50 The Committee notes with interest the continued storage of and delay in disposing of the former Sandline Mi-24 'Hind' attack helicopters. That they have been in storage for almost two decades at cost to the Australian taxpayer is not a desirable situation nor is it one that should ever be repeated.
- 3.51 With the establishment of the Australian Military Sales Office in July 2012 and the reforms that have been introduced there appears to be a positive development in contributing to the resolution of SME disposals. However, the Committee notes the high staff turnover and expresses its concern that through that turnover significant expertise and experience will be lost to the organisation. To ensure that this expertise is maintained, training for new staff is essential but so too is the necessity for departing staff to ensure that their corporate knowledge is preserved and transmitted to incoming staff.

Recommendation 6

- 3.52 **The Committee recommends that the Department of Defence develop comprehensive training programs, instruction procedures and handover briefs for all new Australian Military Sales Office staff.**

Performance Audit Report No. 20 (2014-15)

Administration of the Tariff Concession System

Introduction

4.1 Chapter 4 discusses the Joint Committee of Public Accounts and Audit (JCPAA) review of the Australian National Audit Office (ANAO) Report No. 20 (2014-15) Administration of the Tariff Concession System. The chapter includes:

- an overview of the report, including the audit objective, scope and audit conclusion and audit recommendations
- Committee review
- Committee findings

Report overview

4.2 Customs duty and Commonwealth taxes are imposed on goods when they are imported into Australia. The rate of duty payable in respect of goods is determined by the tariff classification of the product.¹ Imposing duty on imported goods is designed to influence the flow of trade by regulating the value of imported goods and protecting Australia's local economy and industry.²

1 Australian National Audit Office (ANAO) Report No. 20 (2014-15), *Administration of the Tariff Concession System*, February 2015, p. 27.

2 ANAO, Audit Report No. 20 (2014-15), p. 27.

- 4.3 The Tariff Concession System (TCS), which was established in its current form in 1992, is aimed at helping industry become 'more internationally competitive'.³ It also 'reduces costs to the general community by allowing duty-free entry for certain goods where there is no local industry that produces those goods'.⁴
- 4.4 To receive a concession from customs duty under the TCS, an imported good must be covered by a current Tariff Concession Order (TCO).⁵
- 4.5 The TCS is administered by the Australian Customs and Border Protection Service (Customs), however, the Department of Industry and Science (Industry) has responsibility for administering the policy framework within which the TCS is delivered.⁶ Customs is responsible for assessing TCO applications, objections and revocations, as well as managing compliance with TCS requirements and providing assurance that importers applying TCOs are eligible to do so.⁷

Audit objective and scope

- 4.6 The objective of the ANAO's audit was to assess Customs' administration of the TCS and the compliance strategies that have been implemented to mitigate the risks relating to the incorrect application of a TCO.⁸
- 4.7 The ANAO based its findings on an examination of four aspects of the TCS:
- the governance and oversight framework established to administer the TCS
 - the TCO assessment process
 - the processes and systems for ongoing management, review and eventual revocation of TCOs
 - the TCO compliance framework.⁹

3 <http://www.customs.gov.au/webdata/resources/files/commer01.pdf> (accessed 13 May 2015).

4 <http://www.customs.gov.au/webdata/resources/files/commer01.pdf> (accessed 13 May 2015).

5 ANAO, Audit Report No. 20 (2014-15), p. 28.

6 ANAO, Audit Report No. 20 (2014-15), p. 35.

7 ANAO, Audit Report No. 20 (2014-15), p. 17.

8 ANAO, Audit Report No. 20 (2014-15), p. 16.

9 ANAO, Audit Report No. 20 (2014-15), pp. 37-38.

Summary of audit outcomes

4.8 The then Auditor-General, Mr Ian McPhee AO PSM, summarised the key findings of the ANAO's performance audit of Customs' administration of the TCS:

... the mature administrative arrangements established over time have provided a generally sound basis for the assessment and management of tariff concession orders, or TCOs, including the processing of applications, objections, revocations as well as the management of TCOs that are in use.¹⁰

4.9 Despite this finding, the ANAO identified that those administrative arrangements could be improved by developing 'a communications strategy ... and more clearly documenting TCO application assessment activities'¹¹ concluding that Customs was not well placed to determine whether its compliance activities were effectively addressing the risks arising from TCO misuse.¹²

4.10 The ANAO's performance audit report was finalised as Customs had commenced implementing a number of significant reforms, including its amalgamation with the Department of Immigration and Border Protection (Immigration) and the restructure of its compliance function.¹³ As the restructured arrangements are yet to be fully implemented, the ANAO concluded that it was not possible to determine the extent to which those changes would have an impact on compliance activity for the TCS.¹⁴

ANAO Recommendations

4.11 Table 4.1 sets out the recommendations for ANAO Report No. 20 and Custom's response.

10 Mr Ian McPhee AO PSM, Auditor-General (Retired), Australian National Audit Office (ANAO), *Committee Hansard*, 14 May 2015, p. 11.

11 Mr Ian McPhee AO PSM, ANAO, *Committee Hansard*, 14 May 2015, p. 11.

12 Mr Ian McPhee AO PSM, ANAO, *Committee Hansard*, 14 May 2015, p. 11.

13 ANAO, Audit Report No. 20 (2014-15), p. 22.

14 ANAO, Audit Report No. 20 (2014-15), p. 22.

Table 4.1 ANAO recommendations, Report No. 20 (2014–15)

1	<p>To build greater awareness and promote the Tariff Concession System, the ANAO recommends that the Australian Customs and Border Protection Service:</p> <ul style="list-style-type: none"> (a) develops a Tariff Concession System communications strategy, in consultation with the Department of Industry, aimed at increasing system awareness, with a particular focus on local manufacturer engagement; (b) reviews the strategy periodically to inform the ongoing targeting and refinement of communication activities; and (c) reviews the appropriateness and accessibility of Tariff Concession System information that is currently made available to stakeholders. <p>Customs' response: <i>Agree.</i></p>
2	<p>To improve the transparency and accountability of the Tariff Concession Order decision-making process, the ANAO recommends that the Australian Customs and Border Protection Service strengthens its guidance to assessment officers and reinforces the importance of documenting key decisions.</p> <p>Customs response: <i>Noted.</i></p>
3	<p>To better support the delivery and oversight of compliance activities directed at managing the risk of Tariff Concession Order misuse, the ANAO recommends that the Australian Customs and Border Protection Service:</p> <ul style="list-style-type: none"> strengthens its approach to the management of compliance data to better inform its monitoring and reporting of compliance activities; and develops an appropriate set of performance indicators and regularly assesses its performance against these to determine the effectiveness of its compliance program. <p>Customs' response: <i>Agree.</i></p>

4.12 The ANAO explained that its recommendations were aimed at enhancing engagement with key stakeholders; providing greater assurance regarding the assessment and decision-making process; and improving the monitoring and reporting of compliance activities.¹⁵

4.13 Customs agreed to all three of the ANAO's recommendations.¹⁶

Committee review

4.14 Representatives of the following agencies gave evidence at the Committee's public hearing on Thursday, 14 May 2015:

- Australian Customs and Border Protection; and
- Australian National Audit Office.

4.15 Throughout its inquiry, there were two areas of particular interest to the Committee:

- the progress of implementation of the ANAO's recommendations; and

¹⁵ ANAO, Audit Report No. 20 (2014–15), p. 18.

¹⁶ ANAO, Audit Report No. 20 (2014–15), pp. 48, 71, 106.

- how the organisational changes taking place in Customs would affect the administration of the TCS.

Implementation of the audit report's recommendations

- 4.16 The ANAO's audit identified administrative arrangements supporting the TCS that could be strengthened and made recommendations accordingly. The ANAO's recommendations included the development of a communication strategy to improve awareness and stakeholder engagement and more clearly documenting assessment activities to providing greater integrity assurance of the TCO assessment and decision-making process.¹⁷

Development of a communication strategy

- 4.17 In response to the Committee's questions concerning its progress in relation to the development of a communications strategy, representatives of Customs explained to the Committee that initial discussions had been held with Industry and options were being considered:

[T]he strategy will include strategies to reach manufacturers through direct appeals ... through partnering with stakeholders like state government agencies who have an interest in local manufacturing and through general advertising ... [T]he other proposal that we are looking at is expanding our existing website information.¹⁸

- 4.18 Customs gave further detail of their progress, advising that its next step in developing a communication strategy was to consult with state government and industry stakeholders.¹⁹

Improving integrity assurance of the TCO process

- 4.19 Despite its finding that mature administrative arrangements, established over time, had provided a 'generally sound basis' for the administration of the TCS, the ANAO concluded that 'Customs was not well placed to determine whether its activities directed at managing compliance were effectively addressing the risks arising from TCO misuse' and recommended that more be done to strengthen the integrity of the decision-making process.²⁰

17 See: ANAO, Audit Report No. 20 (2014–15), pp. 23, 48, 71, 106.

18 Ms Anita Langford, Acting Assistant Secretary, Trade, Australian Customs and Border Protection Service (Customs), *Committee Hansard*, 14 May 2015, pp. 11–12.

19 Ms Anita Langford, Customs, *Committee Hansard*, 14 May 2015, p. 12.

20 Mr Ian McPhee AO PSM, ANAO, *Committee Hansard*, 14 May 2015, p. 11.

- 4.20 The Committee sought more detail of the resources dedicated to managing compliance data, monitoring and reporting. Customs explained that although 11 full time equivalent staff (FTE) currently manage TCO compliance, as part of its integration with Immigration, a process was underway to determine the level of resourcing needed to manage TCO compliance post 1 July 2015.²¹ In addition, Customs outlined that work was underway to improve its compliance function:
- The service is implementing two initiatives which specifically relate to an enhanced ability to identify and stop non-compliance claims for Tariff Concessions. Two analytics models are currently being developed which will inform information on [TCOs].²²
- 4.21 To deliver these initiatives, Customs has received funding for 16.66 FTE in the current financial year, and further funding to support a maximum of 25 FTE in the 2015-16 financial year.²³
- 4.22 Representatives of the agency also explained that a Revenue and Trade Crime Task Force (Task Force) was established in September 2014 ‘to develop and deliver a number of specific enhancements and efficiency improvements to processes and systems to better address complex revenue evasion and deliver additional revenue to Government’.²⁴ In addition to its role in managing TCO misuse and identifying improvements, the Task Force was also ‘undertaking a project to develop key performance indicators through a comprehensive process review and improvement programme across all revenue and targeting processes’.²⁵
- 4.23 In its audit report, the ANAO commented on the various information technology systems used to administer the TCS. It noted that Customs ‘recognised that its current IT operating environment is characterised by duplication of effort and the inefficient use of resources’ and had ‘embarked on a four-year business alignment strategy that is planned to deliver more integrated, responsive information and services’.²⁶
- 4.24 In response to questions seeking more detail on these changes, Customs further informed the Committee that a project was underway to review the number of systems used and how they are used with a view to,

21 Australian Customs and Border Protection Service (Customs), *Submission 3*, p. 1.

22 Customs, *Submission 3*, p. 4. See also: Mr Kingsley Woodford-Smith, *Committee Hansard*, 14 May 2015, p. 15.

23 Customs, *Submission 3*, p. 4.

24 Customs, *Submission 3*, p. 4.

25 Customs, *Submission 3*, p. 1.

26 ANAO, *Audit Report No. 20 (2014-15)*, p. 52.

through the integration with Immigration, creating efficiencies and returning to one system:²⁷

Most business ICT systems from the Department and the Service [(Customs)] will continue to operate in the new Department as they provide support to specific lines of business (i.e. Cargo Management or Visa Processing). As part of the Portfolio's Reform Programme there is a suite of initiatives, including investment in Intelligence ICT capabilities, to improve support to officers in the Border Force.

...

The service is working to develop a future systems landscape post the consolidation of our organisations that will provide guidance to the lines of business on the systems that we will invest in, maintain or retire. New business systems will be developed to meet new business requirements where appropriate.²⁸

Organisational changes

- 4.25 In its audit report, the ANAO noted that Customs was in the process of significant organisational reform, including its amalgamation with Immigration and the restructure of its compliance function.²⁹ Noting this, the ANAO identified that although it was not possible to determine, at the conclusion of the audit, the extent to which the new arrangements would affect TCS compliance activity, '[t]here would ... be merit in Customs reflecting on the findings of [its] report when implementing revised compliance arrangements as a part of its reform agenda.'³⁰
- 4.26 Noting its broad and varied border responsibilities, the Committee sought to understand how changes to Customs' organisational structure would impact the priority attributed to TCS compliance work.
- 4.27 In response to these questions, Customs explained that although the changes occurring as a result of integration made it difficult to specify how priorities would be determined going forward and the particular priority that would be given to the TCS, it was expected that:
- ... a large part of the Border Force, Strategic Border Command Division, [would have] a significant involvement in terms of ... management around the scheme [TCS] ... and we are potentially looking at around 1500 people dedicated to a number of different

27 Mr Kingsley Woodford-Smith, Customs, *Committee Hansard*, 14 May 2015, p. 15.

28 Customs, *Submission 3*, p. 5.

29 ANAO, Audit Report No. 20 (2014-15), p. 22.

30 ANAO, Audit Report No. 20 (2014-15), p. 22.

priorities. So one officer can be looking at all of those priorities and more broadly across the other kinds of activities that we might be engaged in. A large part of ... [Customs] is in one form or another involved. Whether it be the intelligence side, creating profiles or alerts or activities at the airport in cargo terminals, it is the organisation that is focussed on that.³¹

- 4.28 Customs also described how the structural changes to its compliance function would enable it to centralise the management of risk across the integrated organisation.³²

Committee comment

- 4.29 The Committee acknowledges that Customs is in the process of a significant organisational restructure. This restructure has included amalgamation with the Department of Immigration and Border Protection (Immigration), and from 1 July 2015, the creation of a single border control and enforcement entity: the Australian Border Force (ABF). The ABF will be responsible for all aspects of border enforcement action, including TCO compliance. Following the establishment of ABF, Customs will be abolished as a statutory agency. As a result, the Committee takes the view that the ANAO's performance audit should inform Immigration and the ABF as the significant changes being undertaken continue to be implemented.
- 4.30 The Committee considers that the agency is taking reasonable action to begin implementing the ANAO's recommendations. The Committee encourages Customs to ensure the ANAO's recommendations are reflected upon and influence the design of its compliance function in the new integrated agency.

Recommendation 7

- 4.31 **The Committee recommends that the Department of Immigration and Border Protection report back to the Joint Committee of Public Accounts and Audit, within six months of the tabling of this report, on its continued progress implementing the Australian National Audit Office (ANAO) recommendations in Report No. 20 (2014–15).**

31 Mr Kingsley Woodford-Smith, Customs, *Committee Hansard*, 14 May 2015, p. 15.

32 Mr Kingsley Woodford-Smith, Customs, *Committee Hansard*, 14 May 2015, pp. 16–17. For more information on the Organisation Structure, see:

<http://www.immi.gov.au/About/Documents/portfolio-structure-chart-02032015.pdf>

- 4.32 The Committee considers that there is scope for a broader cross-agency audit of the TCS, beyond its administration, to include aspects such as the policy framework and the TCO objection process. This audit could be undertaken, as appropriate, 12 months following the commencement of the operation of the ABF.

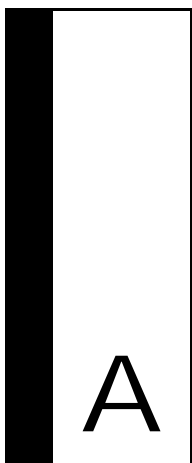
Recommendation 8

- 4.33 **The Committee recommends that the Australian National Audit Office (ANAO) consider undertaking a cross-agency audit (Department of Industry and Science, and the Department of Immigration and Border Protection) of the Tariff Concession System at least 12 months following the finalisation of the Department of Immigration and Border Protection's organisational restructuring and the commencement of the Australian Border Force.**

Dr Andrew Southcott MP

Chair

Date: 25 June 2015



Appendix A – Submissions

Audit Report No. 9 (2014-15)

1. Department of Infrastructure and Regional Development
 - 1.1 Supplementary Submission
 - 1.2 Supplementary Submission
2. Australian National Audit Office
 - 2.1 Supplementary Submission

Audit Report Nos. 19 and 20 (2014-15)

1. Department of Defence
 - 1.1 Supplementary Submission
3. Australian Customs and Border Protection Service



Appendix B – Public Hearings

Audit Report No. 9 (2014-15)

6 March 2015

Australian National Audit Office

Mr Ian McPhee, Auditor General

Mr Brian Boyd, Executive Director

Ms Tracey Bremner, Senior Director

Ms Erica Sekendy, Senior Director

Department of Infrastructure and Regional Development

Ms Lyn O’Connell, Deputy Secretary

Mr Andrew Jaggars, Executive Director

Mr Gordon McCormick, General Manager

Audit Report Nos. 19 and 20 (2014-15)

14 May 2015

Australian Customs and Border Protection Service

Ms Sharon Nyakuengama, Acting First Assistant Secretary

Ms Anita Langord, Acting Assistant Secretary

Mr Kingsley Woodford-Smith, Acting National Director

Mr Bjorn Roberts, National Manager

Australian National Audit Office

Mr Ian McPhee, Auditor-General

Dr Tom Ioannou, Group Executive Director

Mr Mark Simpson, Executive Director

Mr Stuart Turnbull, Executive Director

Mr David Rowlands, Senior Director

Ms Barbara Cass, Group Director

Defence Materiel Organisation

Mr Harry Dunstall, Acting Chief Executive Officer

Department of Defence

Air Commodore Peter Yates, Director

Ms Michelle Kelly, Head of Defence Industry

Mr Geoffrey, Chief Audit Executive