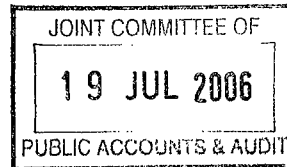




THE HON PETER MCGAURAN MP
MINISTER FOR AGRICULTURE, FISHERIES AND FORESTRY

18 JUL 2006



04 JUL 2006

Mr Tony Smith MP
Chairman
Joint Committee of Public Accounts and Audit
Department of the House of Representatives
PO Box 6021
Parliament House
CANBERRA ACT 2600

Dear Mr Smith *Tony*

I am writing to you to submit the Department of Agriculture, Fisheries and Forestry's response to the Joint Committee of Public Accounts and Audit Report 404. This report was on the development and administration of the Dairy Industry Adjustment Package.

The report made four recommendations that related to the Department, the Dairy Adjustment Authority and the administration of the adjustment Packages. The Department's response has been endorsed by the Secretary of the Department, Ms Joanna Hewitt.

Yours sincerely



Australian Government

Department of Agriculture, Fisheries and Forestry

EXECUTIVE MINUTE

on

JOINT COMMITTEE OF PUBLIC ACCOUNTS AND AUDIT

REPORT [No. 404]

Review of Auditor-General's Reports 2003-04 Third and Fourth Quarters; and First and Second Quarters of 2004-05

General comments

This response addresses recommendations 6 to 9 of the above report by the Joint Committee of Public Accounts and Audit regarding the development and implementation of the Dairy Industry Adjustment Package (DIAP).

The Australian Government Department of Agriculture, Fisheries and Forestry (the Department) recognises the importance of delivering programmes in an efficient and effective manner. The circumstances and external pressures that existed at the time when the DIAP was developed are also relevant to these considerations.

The states, as the jurisdictions responsible for farmgate price regulation, decided to deregulate in March 2000. This move towards deregulation was supported by the Australian Government and came into effect from July 2000. With such a short implementation period it was a major achievement for the Department to have the necessary processes in place at the time of deregulation. The Department successfully developed the framework for the DIAP to ensure the timely delivery of payments to farmers as soon as possible after deregulation took place. Applications from farmers for assistance under DSAP (the first tranche of the DIAP package) closed on 17 August 2000 following a three month claim period.

The DIAP is the largest agricultural assistance package developed to date and given the urgency to deliver this significant assistance package, which was unique in many ways, it proved difficult to always accurately estimate administrative and implementation costs.

While making a number of recommendations for improvements in the administration of the DIAP, the ANAO assessment was that the administration of the DIAP was consistent with Government policy and legislation and that delivery of the package was a considerable achievement. The ANAO assessment of the DIAP was that it was delivered appropriately.

Recommendation No. 6 paragraph 4.62

The Committee recommends that the Department of Agriculture, Fisheries and Forestry ensure that future assistance packages have a clause in relevant legislation which allows for incorrect payments made in error to be reclaimed by the appropriate agency or authority.

THE DEPARTMENT AGREES WITH THIS RECOMMENDATION

The Department recognises the need for public funds to be used in the most cost effective and transparent manner possible. This includes making provisions, in assistance packages, to ensure that the level of any incorrect payments is minimised and where appropriate, incorrectly paid funds be recovered.

The arrangement to not allow for the recovery of incorrectly determined payments in the Dairy Industry Adjustment Package legislation was unique. This was because of the requirement financial institutions placed on farmers to have security from the DAA before providing loans to dairy farmers to help them consolidate or re-ordinate their business. Had the Government not allowed for this, the only option would have been for farmers to receive their payments in quarterly instalments over eight years which would not have facilitated the industry adjustment process so effectively.

Other industry assistance packages administrated by the Department after this time have had provisions included for the recovery of payments made in error. The Farm Help programme, the Exceptional Circumstances programme, the Dairy Type Grant and the Dairy Exit Payment had clauses in the relevant legislation (*Farm Household Support Act 1992*, *Social Security Act 1991* and *Financial Management Act 1997*) to recover any payments made in error. The Department also understands that Centrelink has procedures and systems in place to monitor payments and recover overpayments, and if necessary, would involve the Director of Public Prosecutions if it had exhausted all avenues to recoup overpayments and believed there was a reasonable prospect of conviction.

Last year the Department did exercise its power to recover payments made in error under the Sugar Industry Reform Program (SIRP) 2004. An independent audit, commissioned by the Department to review payments under the first tranche of the Sustainability Grant component of the SIRP 2004, found that a total of 22 payments were made incorrectly, incurring debts totalling \$21,784.16.

After follow-up action, there are only four growers who have not made re-payments (one of whom is deceased). This represents a very small proportion of the \$73 million paid out under SIRP 2004.

The Department supports the effective administration of Government funds and the recovery of payments made in error.

Recommendation No. 7 paragraph 4.63

The Committee recommends that the Government place an overall budget limit on the cost of implementing new assistance packages to encourage administrative cost efficiencies and effectiveness.

THE DEPARTMENT AGREES WITH THIS RECOMMENDATION IN PRINCIPLE.
HOWEVER, DEPENDING ON THE NATURE OF PROGRAMMES, THERE MAY BE
INSTANCES WHEN COSTS NEED TO BE RE-ASSESSED

The Department is committed to effective programme administration and agrees with a budget limit being placed on the cost of implementing new assistance packages. However, it also notes there may be instances where it is necessary to reassess administrative budgets to deal with unexpected circumstances. If budget limits could not be altered, this could result in the programme not delivering adequately against its objectives.

With the Department having minimal time to comprehensively plan for the implementation of the package and given that this type of package had not been delivered before, it was difficult to accurately predict costs of delivering the package. However, the ANAO found that overall there were appropriate administrative procedures in place that gave an assurance that administrative costs were consistent with the Act.

The Department has grant programmes in place which have been designed to be consistent with the better practice guide for administration of grants published by the Australian National Audit Office (ANAO), including the Sugar Industry Reform Programme 2004. These programmes follow the ANAO guidelines to ensure that they remain transparent and accountable to public scrutiny. In addition, the Department has its own instructions in place for the administration of grants. The Cabinet Implementation Unit, within the Department of the Prime Minister and Cabinet, is expected to release later this year its publication 'Better Practice Guide to Programme Implementation'. These guidelines will be incorporated into departmental practice when available.

Recommendation No. 8 paragraph 4.92

The Committee recommends that the Department of Agriculture, Fisheries and Forestry report back to the Committee on the progress and evaluation of the Dairy Structural Adjustment Package and the Supplementary Assistance Program by 30 June 2006. The report should outline progress against each program's original objectives and measurement indicators such as Key Performance Indicators. The report should also outline the Dairy Industry's progress in adjusting to the new economic environment, including exits from the industry.

In November 2003, the South Australian Centre for Economic Studies (SACES¹) evaluated the effectiveness of the DSAP and SDA programmes for the Department. In doing so, it developed measurement and performance indicators that are used in this response to the JCPAA's recommendation.

SACES' view was that both the DSAP and SDA programs performed well on their delivery objectives. The pace of structural adjustment in the industry, which was occurring well before deregulation, was hastened, as the more marginal producers exited the industry with dignity and those farmers that remained made the necessary changes to lower their unit cost structures and enhance their efficiencies. They did this by increasing their herd sizes, retiring debt and/or upgrading capital equipment, some or all of which were partly financed from DSAP/SDA payments.

According to SACES, DSAP/SDA assistance made it a lot easier for the more marginal farmers to leave the industry. Also, DSAP/SDA claims were processed promptly, the program delivery costs were kept to acceptable levels and the uptake of those eligible to apply for assistance was high, indicating that both programs met their delivery objectives.

By 2005 there were a lot fewer farms producing only a slightly lower volume of milk (compared to pre-deregulation), suggesting the dairy industry has made good progress in adjusting to the new economic environment.

Evaluation of the Effectiveness of DSAP and SDA

The enabling legislation for DSAP and SDA does not include explicit performance/measurement indicators. Therefore this response will use those measures that were used by SACES.

In its evaluation, SACES formulated the following indicators for administrative efficiency:

- The level of uptake by those potentially eligible to apply;
- The timeliness of providing for, and processing of, applications to the point where applicants actually received their entitlements;
- The costs of delivering the assistance measures;

for program effectiveness:

- The purpose for which the assistance monies were used and whether it contributed positively to assist dairy farmers adjust to the new, deregulated environment;

¹ South Australian Centre for Economic Studies, Adelaide and Flinders Universities: *Review of the Efficiency and Effectiveness of the Dairy Structural Adjustment Program and Supplementary Dairy Assistance Program*, Final Report prepared for the Department of Agriculture, Fisheries and Forestry, November 2003.

- The extent to which the assistance has avoided the loss of farming enterprises that would otherwise have been viable had the structural adjustment changes occurred over a longer time period.

and for adjustment to the new market environment:

- The extent to which DSAP and SDA assistance was important in enabling successful structural adjustment.

Administrative efficiency

SACES concluded that the uptake of DSAP and SDA entitlements by those eligible to apply was very high. SACES compared the value of payments granted against the value of the rights that might have been awarded on the basis of 1998-99 milk production, and this indicated that the take up rate of DSAP and SDA was a very significant 99.5%. On the basis of this assessment, there is little reason to believe that potentially eligible applicants failed to take up their DSAP or SDA entitlement.

According to SACES, DAA processed over 30,000 DSAP claims, the vast majority of which took just a few months to resolve. Based on the data provided to it, SACES reported that DAA was prompt in its handling of claims. Whilst some claims were protracted, and a few still pending at the time the report was published in November 2003, most of these were not caused by a failure of DAA, but rather due to factors such as applicants' not furnishing sufficient documentary evidence to substantiate their claims.

The two programmes' delivery costs are met from the Dairy Structural Adjustment Fund which is administered by Dairy Australia (DA), the peak industry service provider body. According to the DAA², fully allocated estimated costs in 2006 for administering DSAP and SDA are forecast at \$45 million (2.5% of program costs) to the end of 2010. SACES benchmarked DAA's costs with comparable government agencies that also deliver large programs to the public (eg Centrelink, the Child Support Agency or the Department of Veterans' Affairs) and found that DAA's costs per entitlement holder and costs per claim were in the middle of the range of costs examined. SACES concluded that the DSAP and SDA programmes were delivered in a cost-effective way to the public.

Program effectiveness

In 2001-02, the Australian Bureau of Agricultural and Resource Economics (ABARE) surveyed dairy farmers. On the question of what the assistance monies were used for and their impact on adjustment, the most common use (53% of respondents) was to "pay off or refinance debt", followed by "investment in capital equipment" (36% of respondents) and "income supplementation" (23% of respondents). According to the ABARE survey, only 16% of respondents surveyed used funds to invest in off-farm businesses, purchase other properties or in invest other on-farm enterprises. It can therefore be concluded that the assistance was primarily used to enable producers to either increase their on-farm productivity and/or reduce their unit cost structures.

The number of dairy farms in Australia has trended downwards since the late 1970s, so structural change has been an ongoing process. However, data from DA show that there was a particularly sharp drop in the number of dairy farms immediately following deregulation. From 12,896 in

² Dairy Adjustment Authority (2006), Personal Communication (Daryl Gifford, General Manager, Operations), 9 June 2006.

2000, the number of farms fell by around 28% to 9,256 in the five years to 2005. Compared with the longer term trend of a decline of around 1.6% per years from 1980 to 2000, this suggests that the pace of structural adjustment was greater than would have been the case in the absence of deregulation. Deregulation was widely expected to lead to faster-than-otherwise rate of farm exits, and this is exactly what occurred.

Prior to deregulation, farmers in Queensland, NSW and WA tended to produce higher-priced market milk, with farmers in southern states producing manufacturing milk. SACES found that nearly 90% percent of farmers it had surveyed in Queensland, NSW and WA believed that DSAP and SDA assistance payments were moderately or very important in enabling them to adjust to the new, deregulated environment; 58% of farmers surveyed in Victoria thought DSAP and SDA were important.

This finding is consistent with the higher price received by farmers in Queensland, NSW and WA – and therefore greater impact of deregulation. The Department notes that farmers who were most severely affected by deregulation (NSW, WA and Queensland) generally received more assistance and, therefore, it was of greater importance to them. It is important to note, however, that even in Victoria (with its lower reliance on market milk), over half of respondents said that DSAP/SDA assistance was important in adjusting to deregulation.

In addition to the indicators used by SACES to evaluate the performance of the two programmes, it is also useful to look at two other measures – farm exits and the regions where DSAP/SDA assistance was the greatest. It was widely expected that with the almost overnight removal of all market support measures, there would be a sudden and possibly substantial reduction in farm incomes. It was estimated by Harris³ that after three years of deregulation around 2240 dairy farmers had retired from the industry – a decline of around 17%. The assistance packages gave farmers contemplating exit, especially those most vulnerable, the option of either completely retiring or seeking alternative business or employment opportunities.

Not surprisingly, the greatest proportion of farm exits were from the predominantly market milk states of Queensland, NSW and WA, since their income declines were the sharpest. According to DA figures, between 2000 and 2005, registered dairy farm numbers fell by 43% in Queensland, 38% in NSW and 34% in Western Australia (mainly market milk states). This compares to falls of 22% in Victoria and 30% in Tasmania (predominantly manufacturing milk states).

Not surprisingly also, DSAP and SDA grants were consistently higher in states where market milk sales were a high proportion of total milk output. According to DAA figures (reported in Harris's paper), the average DSAP farm payment in NSW was worth \$196,000, in WA it was \$258,000 and Queensland \$143,000. This compares to an average payment of \$97,000 for Victoria and \$107,000 for Tasmania. Overall 55% of DSAP funds were allocated to the 18% of milk production that was sold for drinking milk, areas where the structural adjustment was always expected to be the greatest. In aggregate, the market milk states (WA, Queensland, NSW) comprise around 22% of total milk production⁴, but their DSAP share was over 41%, while Victoria, which accounts for 65% of milk output⁵ accounted for 46% of DSAP funds.

³ Harris D (2005): *Industry Adjustment to Policy Reform: A Case Study of the Australian Dairy Industry* – A report for the Rural Industries Research and Development Corporation, August.

⁴ Dairy Australia (2005), *Australian Dairy Industry in Focus 2005*, Dairy Australia, Melbourne.

⁵ *Ibid*, Page 15.

Overall, the evaluation conducted by SACES confirms that both DSAP and SDA delivered on their programme objectives. The level of uptake by potential applicants was very high and, for the most part, they were processed in good time. The costs of DSAP and SDA delivery were well within acceptable bounds, and the monies received by farmers were used in a way that facilitated positive structural adjustment. Also, there was marked increase in exits following deregulation and the commencement of DSAP and SDA payments. DSAP and SDA payments were also taken up more by the market milk producers, the ones that faced greater adjustment pressures, indicating that the assistance was used more by those in greater need – an aim of all support programs.

Industry's Progress in Adjusting to the New Economic Environment

To assess industry's progress in the post-deregulation environment, it is useful to consider the extent to which there had been productivity and/or cost improvements since deregulation. An important indicator is economies of scale that result in greater on-farm efficiency and productivity. As shown earlier, farm numbers dropped by nearly 30% in the five years after deregulation. Yet, milk production fell by just under 7% (from 10,847 ML in 2000 to 10,125 ML in 2005)⁶.

It is clear that those farms that remained in the industry increased their production through acquiring more cattle to add to their herds and, as shown by ABARE's survey earlier, by upgrading their capital equipment. Derived data from DA⁷ show the average herd size increased from 168 in 2000 to 217 in 2005. The ensuing economies of scale from the bigger herds enabled farm overheads to be spread over a larger production volume, leading to lower unit costs of production and greater efficiencies.

While the decline in farms may be a contributory reason for the decline in milk production, there were other factors as well, such as increased competition from other beverages like fruit juices.

The evidence suggests that the dairy industry has adjusted well to the deregulated environment. The pace of structural adjustment in the industry accelerated, as the more marginal producers were able to exit the industry with dignity and those farmers that remained made the necessary changes to improve their cost structures and efficiencies (mainly by increasing their herd sizes and upgrading their capital equipment).

⁶ Ibid, Page 15

⁷ Ibid, Pages 9 and 10.

Recommendation No. 9 paragraph 4.98

The Committee recommends that the Department of Agriculture, Fisheries and Forestry ensure that all future agreements with Statutory Authorities include a clause allowing the ANAO access to the premises and records, for auditing purposes.

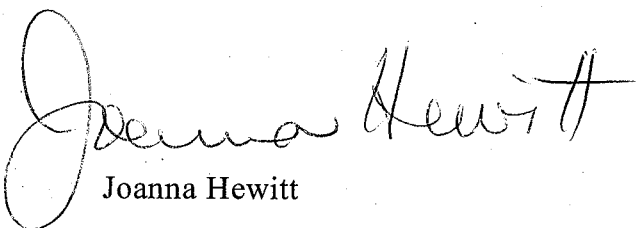
THE DEPARTMENT AGREES WITH THIS RECOMMENDATION

The Department agrees that it is entirely appropriate for the ANAO to access premises and records of Statutory Authorities for auditing purposes. Statutory Authorities are organisations established under the *Commonwealth Authorities and Companies Act 1997*. All agreements the Department has with its Statutory Authorities allows access for auditing purposes. Industry service bodies, including Dairy Australia, operate under the *Corporations Act 2001*. The Department has agreements in place with industry service bodies which include a standard clause allowing the ANAO access to the companies' premises and records, for auditing purposes. The current agreement with DA provides for the Commonwealth or its representative to inspect any premises of the company and examine and copy the company's accounts and records.

The Agreement between DA and the Commonwealth is currently being re-negotiated and a clause allowing ANAO access to the premises and records will also be in the new Agreement.

The Department notes that during the course of conducting its audit of the Dairy Adjustment Authority, the ANAO was given unrestricted access to the premises and all records. The Dairy Adjustment Authority was fully co-operative in every request.

Yours sincerely



Joanna Hewitt