The Parliament of the Commonwealth of Australia

Report 418

Review of Auditor-General's Reports Nos. 04 to 38 (2009-10)

Joint Committee of Public Accounts and Audit

December 2010
Canberra

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Foreword

The Joint Committee of Public Accounts and Audit, as prescribed by the *Public Accounts and Audit Committee Act 1951* examines all of the reports of the Auditor-General tabled in the Parliament. This report details the findings of the Committee's examination of the audit reports tabled between September 2009 and May 2010, during the 42nd Parliament. This report is presented on behalf of the Committee of the previous Parliament, which undertook all of the public hearings.

The Committee examined nine reports covering a range of agencies and identified a number of areas of ongoing concern, including grants administration, the implementation of new technology, risk management and data integrity.

The Committee reviewed the administration of grants by the National Health and Medical Research Council (NHMRC). The Committee acknowledged the benefits to Australian health flowing from research supported by the NHMRC grants system and noted the upheaval caused by the NHMRC's recent separation from the Department of Health and its move to a statutory agency. The Committee recognised that NHMRC is still consolidating its new status but was pleased to see evidence of a tightening in administrative practices, processes and procedure.

The Committee examined the implementation of the Change Program by the Australian Taxation Office. While the Committee noted the significant productivity gains within the Tax Office, it expressed concern about the extent of ongoing client dissatisfaction with the system and the subsequent undermining of confidence in the integrity of Australia's taxation system. The incoming Committee will continue to monitor this situation at the next Biannual Hearing with the Taxation Commissioner.

The Committee also expressed concern over the long term issue of staff churn at AusAID, particularly in light of the growing demands placed on the agency by Australia's expanding aid program. The Committee acknowledged that AusAID is taking positive steps to combat the effects of staff churn on the agency and recommended that AusAID report back to the JCPAA within twelve months of the

tabling of this report on the effectiveness of the draft workplace plan in alleviating this issue.

The Committee reviewed audit reports on a number of controversial topics including the National Broadband Network request for proposal process, the coordination and reporting of Australia's climate change measures and the Building the Education Revolution program. The Committee identified issues with risk management, data integrity and reporting processes and the effect these issues have had on implementation and delivery.

I would like to take this opportunity to thank the previous Committee, chaired by Sharon Grierson MP, for their work. The incoming Committee recognises the important role that the process of scrutinising the reports of the Auditor-General plays in holding the executive and its agencies to account, and looks forward to continuing that process. The Committee will continue to work with the Auditor-General to strengthen accountability and transparency and public administration across the Australian government.

Robert Oakeshott MP
Chair

Membership of the Committee

42nd Parliament

Chair	Ms Sharon Grierson MP
Deputy Chair	Mr Petro Georgiou MP

Members		
	Hon Dick Adams MP (from 17/08/09)	Senator Guy Barnett
	Hon Arch Bevis MP	Senator Mark Bishop
	Hon Bronwyn Bishop MP	Senator David Bushby (until 02/02 /10)
	Mr David Bradbury	Senator David Feeney
	Mr Jamie Briggs MP	Senator Helen Kroger (from 02/02/10)
	Mr Mark Butler MP (until 15/06/09)	Senator Kate Lundy
	Ms Catherine King MP	
	Hon Sussan Ley MP (from 03/02/10)	
	Mr Shayne Neumann MP	
	Mr Stuart Robert MP (until 03/02 /10)	

43rd Parliament

Chair	Mr Rob Oakeshott MP	
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	Mr Jamie Briggs MP	Senator Mark Bishop
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	Ms Laura Smyth MP	
	Hon Alexander Somlyay MP	

Committee Secretariat

Secretary   Mr Russell Chafer

Research Officers Dr Narelle McGlusky

List of abbreviations

AGO	Australian Greenhouse Office
ANAO	Australian National Audit Office
APS	Australian Public Service
AQIS	Australian Quarantine and Inspection Service
ATO	Australian Taxation Office
AusAID	The Australian Agency for International Development
AusLink Act	*AusLink (National Land Transport) Act 2005*
BER	Building the Education Revolution
BGA	Block Grant Authority
BOM	Bureau of Meteorology
CEO	Chief Executive Officer
COAG	Council of Australian Governments
CPE	Change Program Executive
CPGs	Commonwealth Procurement Guidelines
CPRS	Carbon Pollution Reduction Scheme

CPSC	Change Program Steering Committee
CRM	client relationship management system
Customs	Australian Customs and Border Protection Service
DBCDE	Department of Broadband, Communications and the Digital Economy
DCC	Department of Climate Change
DCCEE	Department of Climate Change and Energy Efficiency
DEEWR	Department of Education, Employment and Workplace Relations
DEWHA	Department of Environment, Water, Heritage and the Arts
DIAC	Department of Immigration and Citizenship
DITRDLG	Department of Infrastructure, Transport, Regional Development and Local Government
DoHA	Department of Health and Ageing
DRET	Department of Resources, Energy and Tourism
ECP	Entry Control Point
FAGs	Financial Assistance Grants
FBT	Fringe Benefits Tax
FHSA	First Home Savers Account
FMA	*Financial Management and Accountability Act (1997)*
FTTN	fibre-to-the-node
FTTP	fibre-to-the-premises
G20	Group of Twenty
GGAP	Greenhouse Gas Abatement Program
GHG	Greenhouse Gas
GIC	General Interest Charge

GNI   gross national income

GRP   Grant Review Panel

HR   Human Resources

ICP   Integrated Core Processing

ICT   Information and Communications Technology

IMS   Infrastructure Management System

IT   Information Technology

JCPAA   Joint Committee of Public Accounts and Audit

KPI   Key Performance Indicator

Labor   Australian Labor Party

LETDF   Low Emissions Technology Demonstration Fund

LGA   Local Government Authority

LULUCF   land use, land use change and forestry

MDGs   Millennium Development Goals

MoU   Memorandum of Understanding

Mpbs   megabits per second

MREA   Medical Research Endowment Account

Mt CO2e   Millions of tonnes of carbon dioxide equivalents

NBN   National Broadband Network

NGER Act   *National Greenhouse and Energy Reporting Act 2007*

NHMRC   National Health and Medical Research Council

NHMRC   *National Health and Medical Research Council Act 1992*
Act

NPA   National Partnership Agreement

NSSP   National Solar Schools Program

ODA   official development assistance

ODE   Office of Development Effectiveness

OECD   Organisation for Economic Co-operation and Development

P21   Primary Schools for the 21st Century

PACE   Passenger Analysis, Clearance and Evaluation system

Panel   Panel of Experts

PBS   Portfolio Budget Statement

PFS   Practice Statement Framework

R2R   Roads to Recovery

R2R Act   *Roads to Recovery Act 2000*

RFP   Request for Proposal

RGMS   Research Grant Management System

RRPGP   Renewable Remote Power Generation Program

SHCP   Solar Homes and Communities Plan

SHWR   Solar Hot Water Rebate

SME   Small and Medium Enterprise

SOPs   Standard Operating Procedures

SPBC   Strategic Priorities and Budget Committee of Cabinet

TAS   Tax Administration System

Tax Office Australian Taxation Office

The Deed   Deed of Agreement

UNFCCC   United Nations Framework Convention on Climate Change

List of recommendations

> The Committee recommends that the Australian Taxation Office provide a report on customer satisfaction with the new system, including detailed examination of complaints received, at the next Biannual Hearing with the Committee.

> The Committee recommends that the Australian Agency for International Development (AusAID) report back to the Joint Committee of Public Accounts and Audit within twelve months of the tabling of this report on the effectiveness of the draft workforce plan in alleviating staff churn, quantifying any changes.

> The Committee recommends that the Australian Agency for International Development (AusAID) report back to the Joint Committee of Public Accounts and Audit within twelve months of the tabling of this report on the development and implementation of guidelines on the classification of administered and departmental expenses.

8 Coordination and Reporting of Australia's Climate Change Measures

The Committee recommends that the Department of Climate Change and Energy Efficiency provide the Committee with a progress report within 12 months of the tabling of this report on the concrete measures that have been implemented to improve the effectiveness of Australian government abatement programs.

The report should include:

■ a copy of the finalised abatement measurement guidelines;

■ examples of how 'business as usual' factors and other economic drivers have been taken into account when measuring individual estimates; and

■ a copy of the annual report showing the consolidated abatement figures across responsible agencies.

1

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 that are 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 the audit findings;

- the arguments advanced by the audited agencies; and

- the public interest of the report.

1.2 Upon consideration of 37 audit reports presented to the Parliament by the Auditor-General between September 2009 and May 2010, the Committee selected nine reports for further scrutiny at public hearings.

1.3 The audit reports reviewed by the JCPAA are listed below:

- Audit Report No. 07 2009-10, *Administration of Grants by the National Health and Medical Research Council*;

- Audit Report No. 08 2009-10, *The Australian Taxation Office's Implementation of the Change Program: a strategic overview*;

- Audit Report No. 10 2009-10, *Processing of Incoming International Air Passengers;*

- Audit Report No. 15 2009-10, *AusAID's Management of the Expanding Australian Aid Program*;

- Audit Report No. 20 2009-10, *The National Broadband Network Request for Proposal Process*;

- Audit Report No. 26 2009-10, *Administration of Climate Change Programs*;

- Audit Report No. 27 2009-10, *Coordination and Reporting of Australia's Climate Change Measures*;

- Audit Report No. 31 2009-10, *Management of the AusLink Roads to Recovery Program*; and

- Audit Report No. 33 2009-10, *Building the Education Revolution – Primary Schools for the 21st Century*.

1.4   The public hearings for the reports were held on:

- 11 March 2010 (Audit Report Nos. 10, 20);

- 17 March 2010 (Audit Report No. 15);

- 22 April 2010 (Audit Report No. 08);

- 12 May 2010 (Audit Report No. 07);

- 16 June 2010 (Audit Report Nos. 26,27); and

- 21 June 2010 (Audit Report Nos. 31,33).

1.5   A list of witnesses who appeared at the public hearings is available at Appendix B.

The Committee's report

1.6   This report of the Committee's examination draws attention to the main issues raised at the respective public hearings. Where appropriate, the Committee has commented on unresolved or contentious issues, and has made recommendations.

1.7   The Committee's report is structured as follows:

- Chapter 2 – Audit Report No. 07 2009-10, *Administration of Grants by the National Health and Medical Research Council*;

- Chapter 3 – Audit Report No. 08 2009-10, *The Australian Taxation Office's Implementation of the Change Program: a strategic overview*;

- Chapter 4 – Audit Report No. 10 2009-10, *Processing of Incoming International Air Passengers*;

- Chapter 5—Audit Report No. 15 2009-10, *AusAID's Management of the Expanding Australian Aid Program*;

- Chapter 6—Audit Report No. 20 2009-10, *The National Broadband Network Request for Proposal Process*;

- Chapter 7 – Audit Report No. 26 2009-10, *Administration of Climate Change Programs*;

- Chapter 8 – Audit Report No. 27 2009-10, *Coordination and Reporting of Australia's Climate Change Measures*;

- Chapter 9 – Audit Report No. 31 2009-10, *Management of the AusLink Roads to Recovery Program*; and

- Chapter 10 – Audit Report No. 33 2009-10, *Building the Education Revolution – Primary Schools for the 21st Century.*

1.8 The following appendices provide further information:

- Appendix A – List of submissions; and

- Appendix B – List of public hearings.

1.9 A copy of this report is available on the Committee's website at http://www.aph.gov.au/house/committee/jcpaa/reports.htm.

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Audit Report No. 07 2009-10

Administration of Grants by the National Health and Medical Research Council

Introduction[1]

2.1 The National Health and Medical Research Council (NHMRC) is a statutory agency within the Health and Ageing portfolio, with a total annual budget of around $1 billion. The agency, which has existed in various forms since 1936, is widely regarded as one of Australia's peak bodies in the area of evidence-based health advice, and is a significant provider of grants to support health and medical research in Australia.

2.2 Over the years, NHMRC grants have contributed to progress in many areas of health and medical science, from advancing knowledge and treatment of cancer to preventing cardiovascular disease and improving the health of Aboriginal and Torres Strait Islander Australians.[2] NHMRC investment in health and medical research, on behalf of the Australian Government, is estimated at 16 per cent of the total national investment by

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1   The following information is taken from Audit Report No. 07 2009-10, *Administration of Grants by the National Health and Medical Research Council*, pp. 11-14.

2   NHMRC, *Annual Report,* 2007-08.

both public and private sectors.[3] In 2008, the NHMRC administered 3843 new and continuing grants, accounting for $595 million in expenditure.

2.3   The grants are a vital source of income for many health and medical researchers. Individual researchers can apply to the NHMRC via their universities or research organisations for grants to cover research projects or multi-component research programs, salaries and infrastructure support. The grant process is highly competitive, with less than 30 per cent of applications receiving funding each year.

2.4   Grant applications are assessed on the basis of scientific merit through a process of peer review and expert panels – the objective being to select the highest calibre research for funding. This selection process relies heavily on the participation of NHMRC grants. The integrity of the selection process is therefore fundamentally important, as it underpins the advice that the NHMRC provides to the Minister for Health and Ageing for approval of the grants with the highest potential to deliver beneficial outcomes for Australia.

Changes to the NHMRC since 2006

2.5   In July 2006, the NHMRC became a statutory agency with responsibilities specified under the 2006 amended *National Health and Medical Research Act 1992* (NHMRC Act). The NHMRC Act defines the NHMRC as the Chief Executive Officer (CEO), the Council and its committees and the staff of the NHMRC. The NHMRC is also a prescribed agency under the *Financial Management and Accountability Act 1997* and the *Public Service Act 1999.*

2.6   Since 2006, the NHMRC has experienced a period of transition, facing several challenges as it separates its administrative functions from the Department of Health and Ageing (DoHA) and adjusts it governance and administrative arrangements to support its legislative responsibilities and core business – particularly grant administration. The agency has also had a substantial change agenda, particularly in developing new IT systems to improve its data capacity and grant management functions.

Increased funding for NHMRC grant programs 2000-08

2.7   Funding for NHMRC grants is administered through a special account, the Medical Research Endowment Account (MREA), established under section 49 of the NHMRC Act. From 2000 to 2008, a series of government initiatives to bolster Australia's research capacity resulted in more than a

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3   Department of Health and Ageing, *Portfolio Budget Statements* 2009-10, p. 673.

three-fold rise in the NHMRC's grant budget and a corresponding two-fold increase in active (new and continuing) grants. Over this period, the NHMRC awarded more than eight thousand grants, an investment in research exceeding $3.2 billion.

The NHMRC grant process

2.8   Each year, the NHMRC invites researchers in eligible Australian universities and research organisations to apply for funding through its range of scholarships and research programs. Grant programs generally fall into three groups based on the intended use (or type) of the grant: Research Support; Infrastructure Support; and People Support. In 2007-08 funding for Research Support was $440 million, with the largest scheme, Project Grants, accounting for $283 million of this amount.

2.9   NHMRC grant programs are based on a competitive selection process. Grant applications are reviewed and ranked by a process of peer review, using external assessors and expert Grant Review Panels (GRPs), with a view to selecting research of the highest calibre for funding.

2.10   The NHMRC also calls each year for academics to participate as assessors and members of the GRPs. To comply with the NHMRC's policies and guidelines, and prior to accepting grants for review, these individuals are required to declare any conflicts of interest that could affect their impartiality in assessing and selecting grants.

2.11   In 2008, the NHMRC received over 2586 applications for Project Grants – the largest NHMRC grant scheme. For this scheme, over 449 assessors, 42 GRPs and 499 GRP members were involved in the grant selection process. Based on the selection process, advice is provided to the Minister of Health and Ageing, who has responsibility for the final approval of grants for funding. Success rates vary between the different schemes.

Deed of Agreement with Administering Institutions

2.12   Administering Institutions (mainly universities) play an important role in the NHMRC's grant process, by acting as a conduit for grant enquiries, submission of applications and post-award management of grants.

2.13   Under NHMRC policy, only approved Administering Institutions may receive NHMRC grants. Each Administering Institution must sign a Deed of Agreement (the Deed) with the NHMRC, which establishes the parameters and expectations for the management of grant funds, accountability and reporting requirements. Under this arrangement, each

Administering Institution has responsibility for the effective management of the NHMRC research projects and associated grant funds provided by the Commonwealth. An important role for the NHMRC is in managing the relationship with the Administering Institutions to achieve effective and accountable administration of grants.

Previous audit coverage

2.14   A previous ANAO audit, Audit Report No. 29 2003-04, *Governance of the National Health and Medical Research Council*, examined the governance of the NHMRC and made six recommendations.[4] Subsequent to that audit report, the accountability and governance arrangements of the NHMRC were amended (post Uhrig Review) to reflect a whole of government shift to improved governance and accountability.[5] The NHMRC's revised governance arrangements are examined in the current audit, in the context of grant administration.

The Audit

Audit objective[6]

2.15   The audit objective was to form an opinion on the effectiveness of the NHMRC's grant administration. To meet this objective the NHMRC was assessed against four criteria:

- the NHMRC's governance arrangements provide appropriate accountability that it is meeting its objectives and obligations to Government;

- there are strategic and systematic processes for developing and implementing grant programs;

- the NHMRC manages grants post-award effectively, and complies with legislative requirements and program directives; and

- the NHMRC monitors and evaluates its business to demonstrate that outcomes are being met.

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4   ANAO Audit Report No. 29 2003-04, *Governance of the National Health and Medical Research Council.*

5   J. Uhrig, *Review of the corporate governance of statutory authorities and office holders,* June 2003.

6   The following information is taken from Audit Report No. 07 2009-10, p. 15.

Overall audit conclusion

2.16   The ANAO made the following overall audit conclusion:

> The National Health and Medical Research Council (NHMRC) has a key role in providing grants to support health and medical research in Australia. NHMRC grants are an important source of income for many health and medical researchers, and constitute a substantial Government investment in research and innovation in Australia. Over the period 2000 to 2008, Government initiatives to strengthen Australia's research capability resulted in more than a three-fold increase in NHMRC grant funding, with a corresponding two-fold rise in the number of grants. The NHMRC's investment in research during this time exceeded $3 billion.

> Against this background, since 2006 the NHMRC has been adjusting to its new responsibilities and expectations as a statutory agency. Consistent with the revised *National Health and Medical Research Council Act 1992* (NHMRC Act), high level governance arrangements are in place: a Chief Executive Officer (CEO); established governance structures which include the Council and its committees; and defined responsibilities for each of these governing entities. These arrangements constitute a sound basis for the agency's governance and a platform from which to address challenges and expectations arising from broader Government initiatives to enhance investment in Australia's health research sector.

> However, the NHMRC is an agency in transition, with a substantial change agenda. Particularly evident is the gradual transfer of key administrative functions from the Department of Health and Ageing (DoHA), culminating in the NHMRC's growing administrative independence. In recognising weaknesses in its own management of grants, the NHMRC has also reviewed its grant processes and compliance framework, and commenced a $3 million project to develop a new grant management system.[7]

2.17   The ANAO found a number of shortcomings in the NHMRC's administration of the grant program:

- a lack of consistency in applying guidelines and procedures for specific aspects of the NHMRC's selection process, including conflict of interest provisions;

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7   ANAO Audit Report No. 07 2009-10, pp. 15-16.

- poor compliance in managing grants post-award; and
- the grant management systems do not adequately support the agency's administration of grants or allow sufficient collection of information to report against program outcomes.[8]

2.18   To improve the overall grant administration process, the ANAO suggests that the NHMRC focus on the following:

- enhancing management of key aspects of the grant selection process, including peer review;
- improving assurance of the appropriate management and use of grant funds; and
- implementing an appropriate grant management system.[9]

2.19   The ANAO made the following overall comment on improving these aspects of the grant administration process:

Enhancing management of key aspects of the grant selection process

Selection of grants for funding involves a process of peer review, with appraisal of applications by external assessors and a Grant Review Panel (GRP) comprised of relevant experts. This process carries inherent risks for the NHMRC, as it relies on the commitment of experts from within the research community, who, at times, are members of the NHMRC Council and its committees, assessors and members of GRPs, or are themselves recipients of NHMRC grants. As NHMRC grants are highly competitive, the selection of the highest calibre grants is largely reliant on the NHMRC's ability to maintain a fair and defensible peer review process.

The NHMRC provides guidelines and procedures to assist reviewers in conducting peer review and grant selection, and expects them to adhere to conflict of interest provisions. However, the NHMRC was not consistent in its application of key elements of the grant selection process, including grant eligibility requirements, recording of grant scores and key actions of the GRPs, and implementation of conflict of interest provisions.

Closer monitoring and scrutiny of the selection process is required to provide the NHMRC with the confidence that its policies and guidelines are being consistently and appropriately implemented. Clear recording of the GRP's key actions and recommendations, and the reasons underpinning these, will promote a more

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8   Audit Report No. 07 2009-10, p. 16.
9   Audit Report No. 07 2009-10, p. 16.

defensible grant selection process and better position the NHMRC in responding to unsuccessful applicants or contested grant decisions. Overall, these improvements will allow the NHMRC to achieve greater transparency and probity in its grant selection process.

Improving assurance of the appropriate management and use of grant funds

To provide confidence that Commonwealth funds will be used appropriately and for the purpose they are intended, grants are awarded only to approved Administering Institutions, and administered under a Deed of Agreement (the Deed) that sets out the terms and conditions for the management of grants.

Owing to several shortcomings in the certification of Administering Institutions, and the monitoring and management of grants, the NHMRC is not well placed to provide adequate assurance about the use of grant funds. There is a general lack of compliance monitoring around reconciliation and reporting of grants, with NHMRC's main grant management systems having no monitoring capability. This has diminished the NHMRC's ability to account for grant funds, reducing its efficiency in its own policy for approval of Administering Institutions or a compliance framework for post-award management of grants.

It will also be necessary for the NHMRC to implement a workable risk-based certification process for Administering Institutions and a systematic and sustainable approach to monitoring compliance with the Deeds, reconciliation of grants and recovery of debts.

Implementing an appropriate grant management system

A suitable automated grant management system can assist in monitoring the progress and outcomes of grants. This is particularly the case for the NHMRC given its considerable investment in research and the large volume of applications processed each year.

The NHMRC's information systems do not adequately support the NHMRC's core business – grant management. Its primary grant management system contains substantial data anomalies. Furthermore, the system does not accommodate the monitoring of grants' financial and progress reporting requirements, or capture qualitative information from submitted grant reports. This

diminishes the NHMRC's capacity to gather and evaluate valuable information for reporting against program outcomes.

The NHMRC was advancing development of a new grant management system, and a data repository designed to improve the NHMRC's data capacity. To obtain the most benefit from its new systems will require the NHMRC to focus on system interfaces, adopting a more rigorous but sustainable program of data maintenance and improving staff training in grant management. It is important that the grant system incorporates adequate controls to allow better management of eligibility issues and non-compliance against the Deed.[10]

ANAO recommendations

Table 2.1   ANAO recommendations, Audit Report No. 07 2009-10

1.	To provide adequate assurance that the NHMRC grant funds are being managed appropriately by Administering Institutions, the ANAO recommends that the NHMRC:
	• complete the development and implementation of a risk-based assessment for approval of Administering Institutions, and systematically maintain complete records of those approvals; and
	• implement arrangements to improve monitoring of the Administering Institutions' compliance with the requirements of the Deed of Agreement, including conducting audit activity where a high risk is indicated or persistent non-compliance evident.
	NHMRC response: *Agreed*
2.	To improve the transparency and probity of its peer review process, the ANAO recommends that the NHMRC:
	• monitor the incidence and reasons underpinning the allocation of Grant Review Panel (GRP) members' application to their own GRP for assessment; and
	• enhance the documentation of key actions and recommendations of the GRPs, in order to provide a defensible record of the selection proceedings and strengthen feedback to applicants.
	NHMRC response: *Agreed*
3.	In order to improve the identification and management of conflict of interest, the ANAO recommends that the NHMRC:
	• amend its conflict of interest guidelines to strengthen guidance on acceptable and unacceptable conflicts of interest; and
	• develop a risk-based strategy for more systematic monitoring and review of conflict of interest compliance, including a register of private interests.

10   Audit Report No. 07 2009-10, pp. 16-18.

	NHMRC response: *Agreed*
4.	To improve accountability of grant funds, the ANAO recommends that the NHMRC implement risk-based arrangements including enhanced systems to:
	• manage overdue annual financial reports and final acquittal statements;
	• recover debt due to overpayments and unspent funds; and
	• achieve timely receipt, review and analysis of grants' progress and final reports.
	NHMRC response: *Agreed*
5.	To strengthen the NHMRC's management of grants, the ANAO recommends that the NHMRC include as part of the new Research Grant Management System (RGMS):
	• appropriate compliance controls to identify breaches of legislative, key policy and eligibility requirements for all grant applications;
	• a suitable interface between RGMS and the NHMRC's financial system to allow accurate information exchange and regular reconciliation of the systems;
	• a regular program of data verification and cleansing to prevent corruption of future NHMRC data; and
	• a structured training program and complete documentation for all key processes.
	NHMRC response: *Agreed*

The Committee's review

2.20   The Committee held a public hearing on Wednesday 12 May 2010, with the following witnesses:

- Australian National Audit Office (ANAO); and

- National Health and Medical Research Council (NHMRC).

2.21   The Committee took evidence on the following issues:

- research areas;

- commercialisation;

- conflict of interest;

- assessment and selection of grants;
    ⇒ fairness;
    ⇒ documentation and procedures; and
    ⇒ peer review process;

- Administering Institutions;

- hospitals and smaller institutions; and

- post-award grant management.

Research areas

2.22   The Committee understands that the *National Health and Medical Research Council Act 1992* requires the NHMRC to determine its targets for research grants in accordance with major national health issues identified in consultation with the Minister for Health and Ageing. According to the NHMRC Strategic Plan the research areas remain flexible to accommodate the changing needs of the Australian community over the period of the Plan:

> NHMRC will help Australia deal successfully with health issues as they arise. These include emerging issues for the health system or individuals, or new health and medical research developments. ... NHMRC, therefore, needs to be flexible to meet unforeseen challenges that may arise during the period covered by this Strategic Plan.[11]

2.23   The Committee sought clarification regarding how the NHMRC narrows its research priority areas for grant funding and whether or not the agency places any restrictions on research areas. The NHMRC explained to the Committee that there are no restrictions provided an applicant satisfies the eligibility requirements.[12] The CEO added that NHMRC has developed a series of funding vehicles to ensure a balance of funding between a variety of types of research including laboratory research, clinical research and public health research.[13]

2.24   The Committee asked specifically whether or not complementary health and alternative health were included in the targeted research areas. The NHMRC confirmed that both areas are included in the current Strategic Plan.[14] The ANAO report noted that in 2009, NHMRC received 35 applications for research in these areas and that 12 (34.3 per cent) were funded at a cost of $4.5 million.[15]

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11   *NHMRC Strategic Plan 2007-2009*, p. 17.

12   Professor Anderson, NHMRC, p. 4. All references to witnesses' evidence comes from the Committee's hearing into this audit dated 12 May 2010, with page numbers relating to the Proof Committee Hansard.

13   Professor Anderson, NHMRC, pp. 4-5.

14   Professor Anderson, NHMRC, p. 4.

15   See Table 3.4, Audit Report No. 07 2009-10, p. 68.

2.25   The Committee expressed concern that research aimed at discrediting complementary medicine may be funded and asked for examples of the types of successful projects. The NHMRC maintained that a grant application that showed a 'clearly prejudiced expectation' would not be considered scientifically sound and would not therefore be funded.[16] Professor Anderson described the focus of a number of successful projects in this research area:

> There have been quite a lot looking at Chinese traditional medicine, about the effectiveness of that. There have been some looking at Indigenous Aboriginal traditional medicines. There have been grants looking at the chemistry of extracting of herbs to increase purity and that sort of stuff.[17]

Commercialisation

2.26   The Committee was particularly interested in the commercialisation of research funded through the NHMRC grant program and asked the agency if it had data on the issue. The NHMRC informed the Committee that no rigorous study had been undertaken into the overall monetary benefits of the program but that limited research has been done by Access Economics and the NHMRC itself. The CEO told the Committee that these studies indicated considerable benefits are flowing to the Australian economy from the investment in research:

> (The Access Economics study found) that the benefits to the Australian economy of the cochlear ear implant and CSL, including Gardasil, are about equivalent to the entire government's investment in health and medical research over that period of time. We also did a study a couple of years ago – and we are repeating it – where we looked at 1,208 grants and asked the grantees what the benefits were. Quite apart from the rapid growth in patents and intellectual property protection they have done, they also reported on their leverage of funds into Australia. I think for every government dollar these people levered about 30c one way or another on top of that.[18]

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16   Professor Anderson, NHMRC, p. 4.
17   Professor Anderson, NHMRC, p. 4.
18   Professor Anderson, NHMRC, p. 5.

Conflict of interest

2.27   The ANAO acknowledged that conflicts of interest were inevitable in the peer review process used by NHMRC to assess grant applications, given the 'small pool of researchers available to assess applications in specialist areas' in Australia.[19] However, the ANAO found that the NHMRC guidelines needed to be strengthened to provide 'greater clarity on the types of conflict of interest and situations in which these are relevant' and that conflict of interest declarations needed to be monitored for compliance.[20]

2.28   The Committee asked the ANAO how many potential reviewers declared a conflict of interest. The ANAO replied that, over a two year period, 1,200 researchers had declared a conflict of interest.[21]

2.29   The Committee asked the NHMRC to clarify how the conflict of interest process works. The NHMRC explained to the Committee that every reviewer is asked to declare on every grant application if they have a conflict of interest.[22] If the reviewer declares a conflict of interest they will not see that particular grant application and will be excluded from all consideration of that application:

> The first step is that you do not even get to see the grant in the first place on the panel. Then, when the panel meets, you are outside the room. When the panel is ranking the grants, you are outside the room and the ranking is blind to you.[23]

2.30   Nevertheless, the NHMRC admitted that a grant can go to someone who is on a selection panel. Asked by the Committee to explain how this occurs, the NHMRC reiterated that the reviewer would not be in the room when the application was being assessed but would be present when the cluster of applications was being considered:

> ... they are not there when they are being ranked and not there when they are being reported.[24]

2.31   The NHMRC added that the research community expects an open and transparent system and that the panels are independently monitored to ensure this:

19   Audit Report No. 07 2009-10, pp. 70-71.
20   Audit Report No. 07 2009-10, p. 73.
21   Ms Geue, ANAO, p. 7.
22   Professor Anderson, NHMRC, p. 6.
23   Professor Anderson, NHMRC, p. 8.
24   Professor Anderson, NHMRC, p. 11.

> We have our own staff as well as observers. So we also recruit lay people to look at these panels and report directly to us on how the panel has been operating. This is a very important perception that the research community keep us very much up to the mark on. They want a level playing ground, so they are very diligent with us ...[25]

Assessment and selection of grants

Fairness

2.32   The Committee raised the issue of the fairness of the assessment of grant applications and asked the NHMRC if a reviewer's bias could affect the success of a grant application particularly with regard to fashionable or popular research topics. The NHMRC assured the Committee that the assessment process mitigated the risk of personal bias or prejudice influencing a decision:

> These panels have 10 to 12 people, and the chair's role is to make sure that they are all put to the test in what they are saying. Remember that not only do the panel have another 10 people looking at what they are doing but there are one or two written external reviews on every grant, so there is an independent review by experts. It is not impossible but hard to bring personal prejudice to the table because in this scheme we are funding one in five applications and they are scoring as 'outstanding' and 'excellent' – the very top of the very good. For every one we fund, our panel has ranked three more as worth funding but unable to be funded. The pressure is so high that something that is just a passionate view is very unlikely to get up.[26]

Documentation and procedures

2.33   The ANAO found that the documentation for grant approval often lacked a clear trail and that it was difficult to establish the reason why scores had been altered or budgets reduced.[27] The ANAO told the Committee that records were incomplete and that online databases and hard copy records could not be reconciled.[28] While the ANAO emphasised that it was not

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25   Professor Anderson, NHMRC, p. 11.
26   Professor Anderson, NHMRC, p. 9.
27   Audit Report No. 07 2009-10, p. 66.
28   Ms Geue, ANAO, p. 12.

questioning the legitimacy of grant approval decisions, it identified the issue as a serious impediment to transparency and accountability.[29]

2.34   The Committee asked the NHMRC what steps had been taken to improve documentation and procedures. The NHMRC told the Committee that it is developing and implementing a new Research Grant Management System (RGMS) that will enable online application, appraisal and management of grants.[30] The system is expected to streamline and standardise the process, eliminating many of the discrepancies identified by the ANAO audit.[31]

2.35   Other improvements identified by the NHMRC include the capacity to undertake the peer review process in-house which will allow greater control of documentation and the appointment of an independent chair for every grant review panel.[32]

Peer review process

2.36   Given the inherent nature of the peer review process, the Committee questioned whether or not the ANAO's recommendations for greater accountability and transparency were too demanding. The CEO admitted he had initially had doubts about the practicality of the recommendations but has come to the conclusion that the process will be improved by meeting the requirements:

> I think in the discussions during the review I probably did have some concerns that there was perhaps a misunderstanding about what would work and what does not. Peer review is eventually an opinion by somebody who is worthy to give that opinion, but at the end of the day I think that the recommendations are compatible with nevertheless having high-quality peer review without influencing that. Indeed ... it will improve that. For example, this year for our panels we are going to not only document it more but we are going to be making them nail their colours to the wall on each of our selection criteria, not just the overall one.[33]

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29   Ms Geue, ANAO, p. 12.
30   Professor Anderson, NHMRC, p. 10; Audit Report No. 07 2009-10, p. 89.
31   Professor Anderson, NHMRC, p. 12.
32   Professor Anderson, NHMRC, p. 10.
33   Professor Anderson, NHMRC, p. 16.

Administering Institutions

2.37   The ANAO report was critical of the both the NHMRC's certification process for Administering Institutions and the ongoing monitoring of the Institutions for compliance.[34] The ANAO noted that NHMRC's inability to 'provide assurance that Administering Institutions are sound administrative entities with suitable capability to administer grants' presents a significant risk to Commonwealth funds.[35] The NHMRC had advised the ANAO that it was revising its certification policy and developing and implementing a new compliance framework for Administering Institutions.[36]

2.38   The Committee asked the NHMRC what steps had been taken to implement the new framework. The NHMRC informed the Committee that the agency has set up a separate, independent quality and regulation branch to consolidate the staff and processes involved in the certification procedure.[37] This branch also handles complaints.[38]

2.39   Additionally, the NHMRC has revised the Deed of Agreement, the legal contract between the agency and Administering Institutions setting out terms and conditions for the administration of grants.[39] As at May 2010 the new Agreement is out for consultation with the community and, after relevant feedback is incorporated, will be forwarded to the NHMRC research advisory committee and Council.[40]

2.40   Further, the NHMRC told the Committee that the overall policy framework for Administering Institutions has been updated and as at May 2010 is out for comment.[41] The CEO explained that there have been some delays outside the agency's control in finalising the new policy documentation but it expects completion by the middle of 2010:

> The first is that the Department of Innovation, Industry, Science and Research had just changed their rules about the support of the indirect costs of research, and that has impacted on the relationship between universities and medical research institutes. That has affected the way we need to approach our policy. As you

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34   Audit Report No. 07 2009-10, pp. 52-53.
35   Audit Report No. 07 2009-10, pp. 52-53.
36   Audit Report No. 07 2009-10, p. 53.
37   Professor Anderson, NHMRC, p. 11.
38   Professor Anderson, NHMRC, p. 11.
39   Professor Anderson, NHMRC, p. 11.
40   Professor Anderson, NHMRC, p. 11.
41   Professor Anderson, NHMRC, p. 11.

are probably aware too, the government's considerations around health reform, the role of research in that, and the comments about supporting the current costs of research and training also mean that we need to make sure that our policy does not stand in the way of the cooperation that we hope for. So there have been a couple of background things that have led us to be a little slower than we want.[42]

Hospitals and smaller institutions

2.41   The Committee raised concerns regarding the impediments faced by hospitals and smaller institutions attempting to access NHMRC grant funding. Members of the Committee had received anecdotal evidence that smaller institutions faced significant on-costs in applying for and administering grants.

2.42   The NHMRC admitted that it is easier for larger institutions to absorb on-costs and suggested that 'smaller institutions need to think about whether their overhead costs compared to their research activities are not disproportionate'.[43] However, the NHMRC is aware that their size allows smaller institutions to be more flexible and innovative in their research proposals.[44]

2.43   The NHMRC advised the Committee that it encourages collaborative research approaches to ensure that the capacity of smaller institutions and hospitals can be tapped.[45] The agency explained that Australia has an excellent reputation for collaborative research and that the majority of its grants are awarded to research teams rather than individuals:

> That is the way of medical research these days. You often need, say, a cutting-edge geneticist, a behavioural scientist, an epidemiologist and then a clinical oncologist on a grant. I do think there is something in the Australian characteristic, if you like, that makes that collaboration fairly easy. We hear this from Australians – who think this is a good thing – who come back to Australia after years in, say, the United States, where the culture around this is very different.[46]

42   Professor Anderson, NHMRC, pp. 11-12.
43   Professor Anderson, NHMRC, p. 13.
44   Professor Anderson, NHMRC, p. 13.
45   Professor Anderson, NHMRC, p. 13.
46   Professor Anderson, NHMRC, p. 14.

2.44   The Committee asked for clarification regarding the difficulties hospitals face in accessing research grants. While emphasising the importance of clinical research, the NHMRC explained that currently hospital research does not attract a distinct stream of funding and that research projects may not be a high priority for hospital administrators:

> It does not mean that some hospitals have not been fantastic about that, but, if you are a hospital administrator – if you have ambulance bypass problems or patients stacked up in emergency – you can understand the priority. So I think it is important for the future that the support for clinical research is there beside the patients in the hospital and that the health services research is there in the health system and is supported in that sort of way.[47]

Post-award grant management

2.45   The ANAO found a number of deficiencies in the NHMRC's administration of post-award grant management.[48] The ANAO noted that this has historically been a problematic area for the NHMRC but acknowledged that the agency is taking steps to rectify the issues.[49]

2.46   The Committee asked the NHMRC what changes it had made to achieve the improvements and what success it had had to date. The NHMRC told the Committee it had set up a separate section to handle post-award management and had instituted rigorous processes and procedures to address the issues raised by the ANAO:

> We set up a specific section, developed some very comprehensive standard operating procedures and really focused on the acquittal process.[50]

2.47   The Committee was pleased to hear that outstanding acquittals had been reduced from 1275 in 2008 to approximately 100 as at May 2010.[51]

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47   Professor Anderson, NHMRC, p. 14.
48   Audit Report No. 07 2009-10, pp. 76-88.
49   Audit Report No. 07 2009-10, p. 79.
50   Dr Morris, NHMRC, p. 15.
51   Audit Report No. 07 2009-10, p. 86; Dr Morris, NHMRC, p. 15.

Conclusion

2.48   The Committee acknowledges the benefits to Australian health flowing from research supported by the NHMRC grants system and notes the upheaval caused by the NHMRC's recent separation from the Department of Health and its move to a statutory agency. The Committee recognises that NHMRC is still consolidating its new status but is pleased to see evidence of a tightening in administrative practices, processes and procedure.

2.49   While acknowledging the difficulties inherent in the peer review process, the Committee urges the NHMRC to implement the ANAO recommendations aimed at strengthening accountability and transparency throughout the peer review process. In particular, the Committee is concerned that conflict of interest issues may encourage a perception that the assessment and selection of grant applications is not open and fair.

2.50   The Committee commends the NHMRC for the ongoing improvement in post-award grant management but urges the agency to implement the ANAO recommendation to implement risk-based arrangements to ensure better management of Commonwealth monies.

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Audit Report No. 08 2009-10

The Australian Taxation Office's Implementation of the Change Program: a strategic overview

Introduction[1]

3.1   The Australian Taxation Office (Tax Office) is the Australian Government's principal revenue collection agency. As the main administrator of Australia's tax and superannuation systems its role is to effectively manage and shape the processes and systems which assist taxpayers to meet their tax obligations. Tax administration depends crucially on Information and Communications Technology (ICT) systems. ICT systems are required for every phase of tax administration from the registration of a taxpayer, through to the issuance of an assessment and, if necessary, the conduct of compliance investigations.

3.2   Following the implementation of the Government's significant tax reforms in 2000, the Tax Office began an initiative to make compliance with tax law easier, cheaper and more personalised. The Tax Office was becoming less able to properly respond to government and community expectations

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1   The following information is taken from Audit Report No. 08 2009-10, *The Australian Taxation Office's Implementation of the Change Program: a strategic overview*, pp. 13-26.

in relation to its role as Australia's principal tax and superannuation administrator. The Tax Office considered that tax administration in Australia could not proceed efficiently and effectively without it replacing its substantial and complex ICT systems. This initiative was developed under the banner of the Change Program.

Planning of the Change Program

3.3   By 2000 it was clear to the Tax Office its ICT systems were unsustainable. It was taking too long to respond to Government policy initiatives, the community was getting less efficient service and Tax Office staff were finding reduced capability in the Information Technology (IT) platform. In addition, the Tax Office had been aware for some time of inefficiencies in the ICT systems on which the administration of Australia's taxation and superannuation systems depended.

3.4   The Tax Office had also identified other reasons for embarking on the Change Program additional to the need to replace core ICT systems. These included:

- the need to function as one integrated entity able to address all relevant aspects of taxpayer and tax professional experience of tax administration in a holistic and integrated manner;

- the need to adopt, as efficiently and effectively as possible, better administrative practices and technological facilities in a rapidly changing environment;

- the need to achieve significant productivity improvements in an environment of continuing fiscal constraint;

- continuing to improve community compliance;

- reducing risks to revenue; and

- providing increased confidence in the integrity of Australia's taxation system.

The intent of the Change Program

3.5   The Tax Office planned to replace all tax processing ICT systems with one Integrated Core Processing (ICP) ICT system through the Change Program. In addition, the Tax Office planned to replace the large number of specialised ICT systems that supported internal administrative functions with a single management system. Through the Change Program, the Tax Office intended to transform the way the organisation

functioned by developing a significantly more cost-effective and integrated system of tax administration providing improved services to the community, including secure online facilities. The intention was to make compliance with tax law easier, cheaper and more personalised. Amongst other things, this would enable taxpayers to be engaged in tax administration in a more differentiated manner having regard to considerations of risk and complexity of tax affairs.

3.6   The Tax Office Executive approved the Change Program business case on 10 December 2004 with the intention of completing the Change Program by June 2008. The initial release schedule consisted of:

■ Release 1 (to be completed by June 2005): The installation of a client relationship management system (CRM); improvements to online systems (tax agent and business portals); and a new system to develop and maintain the content of letters;

■ Release 2 (to be completed by September 2006): The installation of a single case and work management system; the introduction of analytical models; enhancements to the CRM; and, enhancements to taxation portals; and

■ Release 3 (to be completed by June 2008): The installation of the ICP system for all tax products; extension of the case management system to a wider audience; new tax agent and business portals; and updates to work management, CRM, analytics, content and records management and reporting. The new ICP software would be developed from Accenture's propriety Tax Administration System (TAS), specifically TAS version 4, modified to suit Australia's tax law and to accommodate specific Tax Office requirements.[2]

3.7   The Tax Office engaged Accenture under a purchaser/provider contract to develop the Change Program's ICT systems as specified in the implementation schedule.

Change Program governance

3.8   Governance of the Change Program has been established through a range of committees as well as the Tax Office/Accenture contract and related

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2   The Tax Office selected the global management consulting, technology services and outsourcing company Accenture to work with it on the initial strategy setting and high level design of what was to become the Change Program. The initial strategy was approved in March 2004 and design work for the ICP began in 2005, two years before a planned deployment in the production environment.

governance documents. Under the terms of the program implementation contract, delivery of the Change Program against the business case is the responsibility of Accenture. Ultimate accountability for delivery of the Change Program, however, rests with the Tax Office. The governance arrangements allow for flexibility to adapt the Change Program to meet new government requirements and facilitate implementation learnings.

3.9   Executive management of the Change Program occurs through the Change Program Steering Committee (CPSC) and the Change Program Executive (CPE). The CPSC is chaired by the Commissioner and includes the Second Commissioners. Its role is to ensure the Tax Office delivers the improved client experiences described in *Making it easier to comply*. The CPSC determines outcomes and priorities for the Change Program and approves significant scope, strategy, design, business case and client experience changes.

3.10   The governance of the Change Program requires assurance capabilities that are commensurate with the complexity and risks of developing the ICP to the required 'fit-for-purpose' standard.

International experiences in implementing large scale ICT projects

3.11   Around the time the Tax Office began planning the Change Program, the Organisation for Economic Co-operation and Development (OECD) released a paper highlighting the experiences of 17 member countries in relation to managing large public sector ICT projects.[3] That paper noted that most governments experience problems when implementing large ICT projects. The paper identified a number of factors that need to be addressed properly if governments are to be successful in getting large ICT projects right.

3.12   Some of the key factors for success outlined in that paper are:

- establishing appropriate governance structures;

- dividing the project into a number of self-contained modules that can be adjusted to changes in circumstances;

- identifying and managing risks;

- holding executive and business line managers accountable; and

- involving end users in the development and implementation.

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3   OECD Public Management Policy Brief No. 8 – *The Hidden Threat to e-Government: Avoiding large government IT failures*. March 2001. Available at <http://www.oecd.org/dataoecd/19/12/1901677.pdf.>

3.13   The OECD paper concluded:

>   The general lesson is not that governments should not take any
>   risks; rather, governments must identify risk, determine which
>   risks they are willing to take, and manage the relevant risk within
>   appropriate governance structures.

3.14   To ensure the overall success of any large scale ICT project it is necessary
to achieve a high level of conformance against each of the key success
factors identified in the 2001 OECD paper.

3.15   By virtue of its nature and scale, implementing the strategic vision and
detailed design specifications for a system as diverse and inherently
complex as the Change Program would require the Tax Office to establish
a structure that addressed these key OECD success factors. Moreover,
international experience in both the public and private sectors has shown
historically that with large-scale, complex projects there is a very real risk
that planning, design and implementation are undertaken on the basis of
overly optimistic estimates, with poor contingency planning and an
underestimation of the severity and impact of identified risks.

Implementation progress and extensions to project scope

3.16   Release 1 of the Change Program was fully implemented in April 2006, 10
months later than originally planned, and Release 2 was fully
implemented in March 2007, six months later than originally planned.

3.17   Largely because of legislative changes, the Tax Office expanded the scope
of the Change Program several times since the implementation phase
commenced. The Tax Office also changed the delivery schedule several
times, partially in response to the changes in scope and partially in
response to general delays in the Change Program's progress. Although
most adjustments to the delivery schedule have been relatively minor,
there have been two significant changes to the schedule.

3.18   The first was in early 2007 when the then Government's superannuation
simplification package of new measures was added to the scope of the
Change Program and a phased approach for Release 3 was proposed. The
second was in mid-2008 following a review in later 2007/early 2008 of
general delays in the Change Program's progress when the Tax Office
again revised the Change Program's implementation schedule. The 2008

revision to the implementation schedule meant that completion of the Change Program would take two years longer than originally planned.[4]

3.19   In December 2007 the Tax Office decided that the initial deployment of ICP should be utilised to process only Fringe Benefits Tax (FBT) returns for the 2007-08 financial year, known as the FBT Release. The Tax Office knew that some of the requisite FBT functionality did not work correctly and proceeded with a phased implementation. The Tax Office had risk mitigation strategies to address identified functionality issues and only released phases after testing. In addition, the warranty arrangements in the Tax Office's contract with Accenture provided the Commonwealth with some protection. The Tax Office considered that the acceptance of incomplete software was justified, given the established risk management arrangements and practical requirements relating to the annual processing of FBT returns.

Change Program funding

3.20   The Tax Office Executive approved the Change Program business case on 10 December 2004 with the intention of completing the program by June 2008. Under the December 2004 business case the total cost of the Change Program was not to exceed $445 million in direct costs over six financial years, starting in 2003-04 and finishing in 2008-09.[5] The Tax Office planned to internally fund this project from its annual appropriations by reducing expenditure on other areas of tax administration.

3.21   As noted above, since the business case was approved in 2004, the scope of the Change Program changed several times, largely due to legislative changes, and the delivery schedule for the Change Program has also changed a number of times. At 30 June 2009 the budget for the expanded scope Change Program is $774 million finishing in 2010-11. This includes the First Home Savers Account (FHSA), which is outside the business case and for which the Tax Office received $25 million.[6] The expansions in scope of the business case required by government (principally superannuation simplification) account for $234 million of the $304 million growth in budget since 2004.

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4   A subsequent review in 2009 has now added another six months to the length of time to be taken until the Change Program is completed.

5   Business Case – Phase 2, Easier, Cheaper and More Personalised Change Program, version 6.3, 10 December 2004, page 2.

6   The FHSA was contracted separately to the Change Program.

3.22   Actual expenditure on the Change Program to the end of 2008-09 was $749
        million.[7] As at 30 June 2009 the Tax Office estimated that, on the basis of
        the Change Program being completed during 2010-11, a further $105
        million may be spent over the next two financial years, bringing the total
        forecast expenditure to $879 million, including the $25 million the Tax
        Office received for the FHSA, which is outside the business case and
        subject to separate contractual arrangements. Forecast expenditure on the
        expanded scope of the Change Program is $434 million more than the 2004
        business case estimated.[8] After taking into account the additional funding
        provided by government to implement legislative changes (such as
        superannuation simplification), the Tax Office expects to absorb within its
        budget appropriation additional estimated expenditure of $247 million
        over the life of the program.

3.23   Expenditure by the Tax Office on the Change Program has been
        capitalised to the extent that such expenditure is expected to provide
        benefits in future years, consistent with the requirements of Australian
        accounting standards.

3.24   The Change Program software, an asset under construction, was written
        down by $75 million to its recoverable amount as at 30 June 2009. This
        reflected the Tax Office's assessment of the asset's current replacement
        cost in accordance with accounting requirements. In making this
        assessment the Tax Office has excluded any amounts relating to cost
        overruns and other costs that are not contributing to the functionality
        required in the completed asset.

3.25   The breakdown of the overall Change Program budget as at 30 June 2009
        is depicted in Figure 1 on page 8 of the Audit Report.

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7   The Tax Office subsequently advised the Committee that as at 31 December 2009 actual
     expenditure stood at $780 million. (Australian Taxation Office, Submission No. 1, Attachment
     4, p. 7.) The Taxation Commissioner told Senate Estimates in June 2010 that actual expenditure
     to 30 June 2010 would be $820 million. (Senate Economics Legislation Committee Estimates, 1
     June 2010, Proof Hansard, p. 83.)

8   This amount is the total forecast expenditure of $879 million minus the 'not to exceed' business
     case budget of $445 million.

The Audit

Audit objective[9]

3.26   The objective of this audit was to provide a strategic review on the progress of the Tax Office's implementation of the Change Program.

3.27   To achieve this, the ANAO examined:

- the planning for, and governance of, the Change Program, particularly in relation to the management of risk and the assurance framework established by the Tax Office, and its management of contractual arrangements for the project;
- implementation issues associated with Releases 1 and 2 of the Change Program, and more specifically in relation to Release 3, the first use of the new ICP system to process FBT returns; and
- the funding of the Change Program, including measurement and attribution of the costs of the project and consideration of any benefits realisation to date.[10]

3.28   The ANAO considered how international experience for similar sized public sector ICT projects may have highlighted key risk areas for consideration. The ANAO also assessed the Change Program for insights that may be relevant to other Australian Public Service ICT projects, having regard to the new arrangements governing ICT activity by *Financial Management and Accountability Act* (1997) (FMA Act) agencies following the Government's announcement on 24 November 2008 that it would implement the recommendations of Sir Peter Gershon's report.[11]

Overall audit conclusion

3.29   The ANAO made the following overall audit conclusion:

> The Tax Office's strategic planning for the Change Program, which began during 2001-2002, emphasised the need to achieve broader long term goals that went beyond just replacing and updating existing ICT functionality. The goal was to develop a significantly more cost-effective and integrated system of tax administration

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9   The following information is taken from Audit Report No. 08 2009-10, p. 21.

10   Audit Report No. 08 2009-10, p. 21.

11   Gershon, P., *Review of the Australian government's use of information and communication technology*, Commonwealth of Australia August 2008. See further <http://www.financeminister.gov.au/media/2008/mr_372008.html.>

> that would provide improved services to the community, including secure online facilities.
>
> The Change Program business case approved by the Tax Office Executive in December 2004 confirmed that the Tax Office had limited viable options for the long term other than to replace its aging ICT systems.[12]

3.30   The ANAO concluded that the original design and implementation plans for the Change Program 'established appropriate governance arrangements for the management' of the Program 'commensurate with the project's anticipated size and complexity as understood in 2004'.[13] Subsequently, overall governance was improved and strengthened following a number of reviews after each implementation phase.[14] Although the initial planning 'broadly addressed the key structural elements for success identified in the OECD's 2001 report about avoiding large government ICT failures', the Tax Office experienced difficulty in three of the five areas:

- dividing the project into more manageable self-contained modules;
- identifying and managing specific risks; and
- adequately involving end users in aspects of the development and implementation.[15]

3.31   The Change Program was initially split into three self-contained releases and the ANAO concluded that:

> The implementation of Releases 1 and 2 have improved and transformed key aspects of Tax Office activity that support tax administration. The Tax Office is now better placed to manage internal administration and communication arrangements with taxpayers, tax professionals and the community. Taxpayer information is now available on a national, integrated risk basis, rather than in a fragmented and regional way.[16]

3.32   The ANAO noted that Release 3 was the 'largest and most complex of the implementation releases' and that the Tax Office originally considered it too difficult to split Release 3 into smaller modules.[17] However, the Tax

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12   Audit Report No. 08 2009-10, p. 21.
13   Audit Report No. 08 2009-10, p. 22.
14   Audit Report No. 08 2009-10, p. 22.
15   Audit Report No. 08 2009-10, p. 22.
16   Audit Report No. 08 2009-10, p. 22.
17   Audit Report No. 08 2009-10, pp. 22-23.

Office advised the ANAO 'that the inclusion of superannuation simplification subsequently required it to change this appraisal'.[18]

3.33   The ANAO concluded that the decision to split Release 3 presented a range of problems:

> Notwithstanding the subsequent decision to split Release 3 into smaller discrete modules, implementing the first of these, FBT returns, was further complicated by the insufficient involvement of end users in the development and testing of the FBT functionality. The effect of this, when combined with the size and complexity of Release 3, meant that the Tax Office's original timetable to fully implement a new ICT system for processing tax returns (i.e. the ICP) was ambitious and, in hindsight, optimistic.
>
> The implementation of the first of the Release 3 modules, FBT returns, encountered some serious difficulties and highlighted a number of shortcomings in managing implementation risks. A significant factor in the problems encountered with the implementation of FBT, including the General Interest Charge (GIC) calculations, was that the testing and assurance processes were inadequate and not carried out in accordance with existing Tax Office standards.[19]

3.34   However, the ANAO concluded that the implementation of Release 3 to date has 'provided a 'proof of concept' test of the ICP's capacity to process tax returns' and 'demonstrated the potential for efficiencies by reducing the extent of manual intervention required of the legacy systems'.[20] The Tax Office acknowledged that the original business case was ambitious and that the scope changed to accommodate government policy initiatives.[21] Under these circumstances, the ANAO concluded that the original plans had to be modified as the Change Program was implemented producing mixed results:

> In this context, success in implementing the phases of the Change Program to date has been mixed, with the implementation of Releases 1 and 2 being generally satisfactory, but the implementation of the FBT Release was less so. The Tax Office considered that the impact of Releases 1 and 2 has been sufficient to demonstrate that implementation benefits exceed original

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18   Audit Report No. 08 2009-10, p. 23.
19   Audit Report No. 08 2009-10, p. 23.
20   Audit Report No. 08 2009-10, p. 23.
21   Audit Report No. 08 2009-10, p. 23.

> expectations for the functionality delivered. Similarly, the FBT
> release demonstrates that the ICP is superior to the FBT systems it
> replaced which operated at a rather low standard of productivity,
> efficiency and effectiveness.[22]

3.35   The ANAO concluded that, given the increased timeframe for the
expected completion of the project, the measurement and attribution of
costs needs to be improved:

> The ANAO considers that there is scope to improve the quality
> and type of management information about both the Change
> Program's costs and benefits. Due to a number of factors,
> including primarily legislative changes, the expanded Change
> Program is now scheduled to take at least two and a half more
> years to complete than was expected in the original business case.
> As the project is largely internally funded, tracking progress
> through accurate and timely information about the deferral of
> benefits, as well as indirect and opportunity costs, is necessary to
> assist the Change Program Steering Committee in the
> management and administration of the project.
>
> The direct and indirect costs associated with maintaining the
> legacy systems, and associated processing 'work-arounds', beyond
> their anticipated decommissioning dates, will result in increasing
> financial pressures on the Tax Office. The ANAO also notes that
> the Tax Office will need to absorb additional estimated
> expenditure of $247 million, incurred over the life of the Change
> Program, within its Budget appropriation.[23]

3.36   In conclusion the ANAO advised that the Change Program still faces
considerable risk and that the task ahead is to implement the lessons
learned to date:

> Notwithstanding the experience to date, the scale and complexity
> of the tasks yet to be completed means that the Tax Office still
> faces significant challenges in finalising the project to a satisfactory
> standard required for the systems which automate most of
> Australia's tax administration. There is a significant risk that the
> deadlines for the completion of further releases may be put under
> pressure or that functionality in the original scope of the Change

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22   Audit Report No. 08 2009-10, pp. 23-24.
23   Audit Report No. 08 2009-10, pp. 24-25.

Program will be reduced so as to meet current budget and timetable expectations.

The experience of the Release 3 FBT implementation has highlighted the importance of end-to-end testing, business pilot with actual production data and full involvement of Tax Office business lines. In addition, there was a need to validate the compliance of the new systems against agreed standards and requirements, including legislative requirements. This will be particularly important for the income tax phase of Release 3 which delivers systems that will automatically finalise tax liabilities and credits for almost all of Australia's approximately 14.5 million tax returns. There is also the potential for further changes to the systems in light of new policy measures arising out of the Henry review.[24] Such developments could necessitate a review of work priorities and a further reconsideration of the current implementation schedule.

The Tax Office's experience to date underlines the importance during the remainder of the Change Program of:

- closer monitoring of significant risks and corresponding mitigation strategies, and setting higher, more verifiable standards for 'fitness for purpose' over the quality of work completed by the contractor;

- following sound project management practices during the design, development and assurance stages for future ICP releases; and

- requiring that prior to the release of ICP software into production, end-to-end testing, business pilot with actual production data and assurance processes are completed with the full involvement of Tax Office business areas.[25]

3.37   The ANAO also concluded that the lessons learned can be applied across the Australian Public Service (APS) as other departments and agencies face the prospect of replacing large ICT systems in response to the Gershon recommendations:

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24 On 13 May 2008 the Australian Government announced a review of Australia's taxation system. This review, chaired by Dr Ken Henry, Secretary of the Treasury, looked at the current tax system and made recommendations to position Australia to deal with the demographic, social, economic and environmental challenges of the 21st century. The final report was presented to the Treasurer in December 2009. See <http://www.taxreview.treasury.gov.au> [accessed 9 March 2010].

25 Audit Report No. 08 2009-10, pp. 25-26.

The Government's decision to accept the recommendations of Sir
Peter Gershon's report means that there will be significant changes
to the governance of large ICT projects within FMA Act agencies
and to whole-of-government approaches to ICT matters in the
future.[26] The ANAO considers there are some lessons from the
experience of the Tax Office in the implementation of the Change
Program which can be applied as the Government moves to
implement the recommendations of the Gershon report across the
APS.

ANAO recommendations

Table 3.1   ANAO recommendations, Audit Report No. 08 2009-10

1.	The ANAO recommends that, in order to better manage risks to the Change Program, the Tax Office more effectively utilise its available assurance framework (compliance assurance, internal audit, the contracted independent assurer), including end-to-end system testing involving operational areas, during the remaining implementation phases of the Change Program.
	Tax Office Response: *Agreed*
2.	The ANAO recommends that in order to improve the governance of the Change Program, the Tax Office amend the Contract (Schedule 2) to clearly set out the high level governance arrangements.
	Tax Office Response: *Agreed*
3.	The ANAO recommends that in order to continually improve the performance of those functions transformed by Change Program releases, the Tax Office review existing Tax office management frameworks to take into account the enhanced performance measurement and reporting capabilities of new systems so as to: a) improve the Tax Office's capacity to evaluate the efficiency, productivity and effectiveness of performance on a whole-of-Tax Office basis; and b) evaluate the scope to improve performance by the use of methodologies that measure and compare performance at an organisational group level.
	Tax Office Response: *Agreed*
4.	The ANAO recommends that in order to improve the strategic management of the Change Program, and having regard to existing management reports, the Change Program Steering Committee periodically receive additional summary, high level reports covering: a) the broad range of costs and benefits attributable to the Change Program; and b) the progress of the Change Program in achieving the strategic goals originally determined.
	Tax Office Response: *Agreed*

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26   'End-to-end testing' requires assessment of systems on a fully integrated basis.

The Committee's review

3.38   The Committee held a public hearing on Thursday 22 April 2010, with the following witnesses:

- Australian National Audit Office (ANAO); and

- Australian Taxation Office (ATO).

3.39   The Committee took evidence on the following issues:

- capacity of the new system;

- systems architecture;

- governance of the change program;

- testing of the system;

- funding and resources;

- IT contracts; and

- lessons learned.

3.40   In addition to the hearing on the audit report, there was some further discussion during the Committees biannual hearing with the Commissioner held on the same day. The transcript of the biannual hearing is available on the Committee website.[27]

Capacity of the new system

3.41   The ANAO noted that there had been considerable slippage and expansion in scope to the original change program due to legislative changes.[28] The Tax Office supported this view identifying the superannuation simplification changes as the most significant driver of the extensions to the project's scope and told the Committee that the Tax Office could not anticipate legislative change.[29] The Committee asked if this indicated that the new system would not have the capacity to cope with future changes to the taxation system.

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27   Joint Committee of Public Accounts and Audit:
      http://www.aph.gov.au/house/committee/jcpaa/taxationbiannual0410/index.htm.

28   Audit Report No. 08 2009-10, pp. 65-68.

29   Mr Butler, ATO, p. 2. All references to witnesses' evidence comes from the Committee's hearing into this audit dated 22 April 2010, with page numbers relating to the Proof Committee Hansard.

3.42   The Taxation Commissioner maintained that, providing future changes
        were similar to those in the past, the new system could cope with them.[30]
        The Tax Office added that the new system would respond more quickly to
        such changes providing better service to the Australian public.[31] The
        Taxation Commissioner explained that the architecture of the new system
        made it 'more flexible and agile in incorporating legislative changes than
        the old system'.[32] He indicated that every year the taxation system is
        adapted to cope with budget changes:

>   The idea of legislative change is one we have to cope with every
>   year. Sometimes our systems can be adapted; sometimes we have
>   to build new systems. This new platform is more adaptable than
>   our past platform, but it is still dependent on the nature of the
>   proposals.[33]

Systems architecture

3.43   The Committee sought clarification on the architecture of the new system.
        The Committee recognises that open standards offer efficiencies through
        interoperability and asked the Tax Office if these had been applied or
        required for the new system. The Tax Office explained that the new
        system is designed on a documented, modular architecture and told the
        Committee:

>   The change program has been basically architected on service
>   oriented architecture principles. We talk about open standards.
>   The use of those SOA principles has an alignment with that.[34]

3.44   The Committee noted that a key part of obtaining efficiency in the Tax
        Office was the concept of one source of data and asked the Tax Office how
        the existing legacy systems and databases will relate to the new unified
        source of data regarding managing accounts. The Tax Office informed the
        Committee that the underlying design principle for the new system
        included a single client account and the use of single processes.[35] The Tax
        Office cited two examples to demonstrate this principle and show how

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30   Mr D'Ascenzo, ATO, p. 5.
31   Mr Butler, ATO, p. 5.
32   Mr D'Ascenzo, ATO, p. 4.
33   Mr D'Ascenzo, ATO, p. 5.
34   Mr Gibson, ATO, p. 12.
35   Mr Gibson, ATO, p. 12.

existing data is aligning within the Change Program: the case management system and the client register:

> ... we have now one case management system where previously we had 180 or so. That is now universally used consistently through the office with a range of case types.[36]
>
> ...
>
> ... another feature would be that in the past we have had multiple client registers and we now have a single logical client register. There are multiple physical ones but there is only one master register and the subservient ones read from the master.[37]

3.45   The Committee asked the Tax Office to provide specific examples of how the architecture of the new system will encourage innovation within the taxation system. The Tax Office identified the development and processing of various forms as one area where the new system will prove cost-effective:

> At the heart of the Change Program we have introduced an architecture that is around forms processing. Right in the heart of that processing we have a forms processing engine and, unless there are some basic business process changes, we will not need to make changes to that engine. We will be introducing variations to our new forms and that will feed through. Previously, we would have had to spend many, many months in detailed processing logic and code changing all of that just to make a relatively minor change. That is a huge step forward in terms of agility and cost-effectiveness. It is really unique.[38]

Governance of the change program

3.46   The ANAO noted that the Change Program Steering Committee (CPSC) currently does not receive 'periodic reports providing synoptic overviews of the impacts of the Change Program on the Tax Office or the community' although this information may be available in disparate reports.[39] The ANAO recommended that the CPSC receive 'additional, periodic, high

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36   Mr Gibson, ATO, p. 13.
37   Mr Dark, ATO, p. 13.
38   Mr Gibson, ATO, p. 13.
39   Audit Report No. 08 2009-10, p. 23.

level reports that address factors broader than those in the Change
Program's business case'.[40]

3.47   The Committee asked the Tax Office what steps have been taken to
provide the CPSC with additional reports covering the progress of the
Change Program in achieving the strategic goals and the broad range of
costs and benefits of the Program. The Tax Office admitted that these two
areas had been looked at separately in the past but that the first quarterly
report combining the two areas was due in April 2010.[41]

3.48   The Committee queried the effectiveness of a quarterly reporting
timeframe, expressing concern at the response time lag to problems. The
Tax Office assured the Committee that the CPSC receives detailed
monthly reports on client experiences which allow a quick response to
problems.[42] However, the Tax Office explained that assessing costs and
benefits against strategic goals is now carried out on a quarterly basis:

> That is not the sort of thing you would review every month. We
> have looked at that and said that every quarter we will look at that
> and assess that. We believe we were doing it in a separate sense,
> and now it is bringing it together.[43]

Testing of the system

3.49   The Tax Office used the processing of Fringe Benefit Tax (FBT) returns for
the financial year 2007-08 to test the Integrated Core Processing (ICP)
system. The ANAO found that there had been insufficient end-to-end
testing[44] carried out during this process and suggested that this issue
needed to be addressed to avoid future delays and wasted resources.[45]

3.50   The Committee asked the ATO why the FBT system had not been
comprehensively tested before release. The Tax Office explained that
manufactured data rather than real data was used to test the system
because the Tax Office was still in the process of developing a mature data

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40   Audit Report No. 08 2009-10, p. 23.
41   Mr Butler, ATO, p. 11.
42   Mr Butler, ATO, pp. 11-12.
43   Mr Butler, ATO, p. 12.
44   End-to-end testing refers to system testing to establish confidence that all elements (as distinct
from discrete processes and/or elements) of the application work together and that the system
as a whole is 'fit-for-purpose' as a fully integrated system. (Audit Report No. 08 2009-10, p. 7)
45   Audit Report No. 08 2009-10, pp. 100-107.

conversion regime.[46] The manufactured data did not reflect the 'actual examples of what happens in a day-to-day sense'.[47] In consequence there were unanticipated results and the tax returns had to be manually processed.[48]

3.51   The Tax Office explained that the FBT return had been chosen as it involved only 75,000 clients enabling tight risk control.[49] The Tax Office assured the Committee that in subsequent financial years the FBT returns had been processed with no problems of any magnitude.[50]

3.52   The Committee asked the Tax Office what steps had been taken to improve end-to-end testing before the rollout of the rest of the new system. The Tax Office maintained that subsequent to the initial roll out of the FBT platform a comprehensive test program had been put in place:

> We had, I think, 3,000 test scripts that went through and tested all the scenarios we could think of. We did things like a parallel run. We took a whole day's worth of returns that had been through the old national taxpayer system and put them through the new system, not to go out to taxpayers but to test that the amounts that came out were correct. ... Also, when we first started to use the income tax system we had a thing called a run ahead. Each day, before we answered anything out of the office, we put all the assessments through to make sure they all looked right, that the numbers were right, and then we put them through to issue to taxpayers.[51]

3.53   The Committee asked the ANAO if this testing program satisfied their requirements. The ANAO acknowledged that since the time of the review the Tax Office had instigated a program with features that ensure comprehensive end-to-end testing.[52]

Funding and resources

3.54   The ANAO noted that in 2004 the estimated cost of the original Change Program Business Case was set to not exceed $445 million over six

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46   Mr Dark, ATO, p. 8.
47   Mr Ryan, ATO, p. 9.
48   Mr Butler, ATO, p. 9.
49   Mr Butler, ATO, p. 10.
50   Mr Butler, ATO, p. 9.
51   Mr Butler, ATO, p. 7.
52   Mr Chapman, ANAO, p. 8.

financial years from 2003-04 to 2008-09.[53] By the end of 2008-09 actual
expenditure on the Program was $749 million and this figure was
expected to reach $879 million by the time the Program was completed in
2010-11.[54] The ANAO found that the additional legislative requirements
were the primary reason for the significant cost increases.[55]

3.55   The Committee asked the Tax Office if it was likely to need further
        funding to complete the project. The Tax Office explained that it will not
        require any further funding to complete the current contract but if further
        expansion of the system is required, further funding will be sought:

> Our main contract provider is Accenture, and we have had
> negotiations with them to finalise the current contract. That is
> completed. ... Any further work we do will be on the basis of a
> new contract and that will clearly need to incorporate whatever
> may come out of the Henry review and other things we see as
> important. In a contract sense, the contract comes to an end but the
> work needs to continue.[56]

3.56   The Tax Office added that, originally, the new IT system was to include
        the Tax Office's accounting system but it has decided not to progress with
        this development at present.[57] If the IT system was expanded to cope with
        the accounting system, further funding would be required:

> We started with the goal of having a fully integrated IT system for
> everything. What we have now is an integrated tax system for
> everything except our accounting. We can make that work quite
> efficiently. We are challenging ourselves: do we actually want to
> go to that extra step and put accounting into the system? The ideas
> were developed back in 2004, so I think it is absolutely appropriate
> that we now pause and rethink those.
>
> ...
>
> If we were to do that work, it would [require more funding], yes.[58]

3.57   The Committee asked if the Tax Office's resource levels were adequate to
        cope with the changes to its operations initiated by the Change Program.
        The Tax Office maintained that, overall the Office will come within budget

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53   Audit Report No. 08 2009-10, p. 114.
54   Audit Report No. 08 2009-10, p. 115.
55   Audit Report No. 08 2009-10, p. 115.
56   Mr Butler, ATO, p. 5.
57   Mr Butler, ATO, p. 3.
58   Mr Butler, ATO, p. 5.

this financial year. With regard to the IT program, the Tax Office told the Committee it has employed extra temporary staff to facilitate the processing of refunds but, if policy changes necessitate the building of new systems, some further funding may be required.[59]

IT contracts

3.58   The Committee asked how the Tax Office is structuring its contracts with its IT service and hardware providers to optimise the Department's ability to innovate while minimising expensive contract variations. The Tax Office informed the Committee it is currently in the process of refreshing all of its existing infrastructure service contracts to ensure efficiency and flexibility:

> ... we make very clear that we are looking for outcomes and there are principles around business architecture and so on that we are saying they will comply with and support us here. Being overly specific in some of the more technical areas stifles innovation as well.[60]

Lessons learned

3.59   The Committee acknowledged that many departments are facing major ICT upgrades in coming years and that the Change Program has provided valuable lessons that should guide future projects. The Committee asked the ANAO what steps have been taken to document the process and disseminate the information for the benefit of relevant departments and agencies.

3.60   The ANAO confirmed that it is producing and distributing a series of Better Practice Guides that document the lessons learned from this and similar projects. Additionally the ANAO informed the Committee that a number of other initiatives are contributing to the dissemination of useful information on large ICT upgrades:

> I am not aware of central agencies having a particular approach to it, but obviously there were initiatives that came into the Gershon review, gateway reviews and a broader role of Department of Finance to have a greater insight into some of the change programs that are occurring.[61]

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59   Mr D'Ascenzo, ATO, p. 6.

60   Mr Gibson, ATO, p. 13.

61   Mr Chapman, ANAO, p. 14.

Conclusion

3.61   The Committee recognises the scale and scope of the Change Program and acknowledges the inherent difficulties in implementing such a diverse and complex project. The Committee notes the significant gains that have been made with regard to productivity improvements within the Tax Office and is aware that further improvements will eventuate as the system is streamlined and current issues resolved.

3.62   However, the Committee is concerned about the extent of ongoing client dissatisfaction with the system. Although the Tax Office maintains that the system is working, media reports and anecdotal evidence indicate that significant numbers of tax payers have been inconvenienced, some seriously, by long delays in receiving taxation returns.[62] In June 2010, a Senate Estimates hearing was told that the Tax Office had received 17000 complaints since the 1 February 2010, a five-fold increase on figures for the same period in previous years.[63] The Committee is concerned that such incidents have undermined confidence in the integrity of Australia's taxation system and will continue to monitor the situation.

3.63   The Committee recommends that the Tax Office monitor and evaluate customer satisfaction with the new system and provide a report to the Committee at the next Biannual Hearing. The report should detail complaints received and include a statistical comparison with previous years.

Recommendation 1

The Committee recommends that the Australian Taxation Office provide a report on customer satisfaction with the new system, including detailed examination of complaints received, at the next Biannual Hearing with the Committee.

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62   The Hon Ms Ley, Member for Farrer, p. 7. See for example, Sabra Lane, 'Computer glitches leave taxpayers on struggle street', *ABC News*, April 15, 2010 and Jacob Saulwick, 'Human error to blame for delays to refunds', *Sydney Morning Herald*, April 20, 2010

63   Mr Butler, Senate Economics Legislation Committee Estimates, Proof Hansard, 1 June 2010, p. 85.

3.64　　The Committee notes that the Inspector-General of Taxation is undertaking an inquiry into the implementation of the Change Program and looks forward to the results of that inquiry in due course.

4

Audit Report No. 10 2009-10

Processing of Incoming International Air Passengers

Introduction[1]

4.1   The Australian Customs and Border Protection Service (Customs) plays an important role in preventing the illegal movement of people and harmful goods across Australia's borders. The agency is required to process travellers (passengers and crew members) entering and departing Australia by air or sea, and identify persons of interest consistent with immigration, health, family law, law enforcement, and national security requirements.

4.2   In December 2008, the Prime Minister announced that the then Australian Customs Service would be re-named the Australian Customs Service and Border Protection Service and that it would be given additional capabilities to respond to people smuggling by boat. A number of activities associated with the response to the increase in people smuggling by sea were transferred to Customs from the Department of Immigration and Citizenship (DIAC).

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1   The following information is taken from Audit Report No. 10 2009-10, *Processing of Incoming International Air Passengers*, pp. 11-13.

4.3   Customs processes travellers at the primary line where, on behalf of DIAC, it provides the primary immigration clearance function. There is a Memorandum of Understanding (MoU) between Customs and DIAC for the provision of these clearance services. DIAC undertakes secondary immigration clearance as required.

4.4   Passenger volumes have been growing at major Australian international airports.[2] In particular, Customs experienced strong growth at Gold Coast and Darwin airports, where new services to Asia were introduced, and at Perth.

4.5   In 2007, Customs reported 23.544 million incoming and outgoing passengers (by air and sea) to Australia, and expected an increase to 34.152 million by 2015.[3] Visitor arrivals by air are expected to grow on average by 4.9 per cent per annum. Notwithstanding the impact of the current economic downturn, the number of international air passengers entering Australia is estimated to increase from 22.9 million in 2005-06 to 29.9 million in 2011-12.

The Audit

Audit objective[4]

4.6   The objective of the audit was to assess Customs' processing of incoming international air passengers in the primary line, in particular the extent to which: (a) systems and controls effectively support the referral of incoming air passengers who pose a risk and those carrying prohibited items; (b) air passengers presenting an immigration risk are processed appropriately; and (c) Customs has arrangements in place to effectively promote co-operation and information sharing with DIAC.

4.7   The audit focused on assessing Customs' systems, controls and mechanisms for information sharing and other arrangements in place to process incoming international air passengers in the primary line. This audit is the first in a planned program of audit work in passenger processing.

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2   The major Australian international airports are in: Sydney; Brisbane; Cairns; Darwin; Melbourne; Adelaide; Perth and Gold Coast.
3   Australian Customs and Border Protection Service, *Strategic Outlook 2015*.
4   The following information is taken from Audit Report No. 10 2009-10, p. 12.

Overall audit conclusion

4.8   The ANAO made the following overall audit conclusion:

> Customs is processing millions of passengers across the border each year and carries out various functions on behalf of other agencies. To fulfil its role, Customs needs to strike an appropriate balance between facilitation and control in the movement of people and goods across the border. In particular, the agency requires sufficient trained staff, supported by effective processes and technology to select, search and examine those movements posing the greatest threat to border controls.
>
> Overall, the ANAO concluded that Customs' management arrangements in the processing of incoming international air passengers in the primary line are broadly effective. Air passengers presenting an immigration risk are processed appropriately. The routine for Customs officers undertaking primary line activities has been specifically designed in conjunction with DIAC to mitigate immigration risks at the border; and the routine was generally adhered to. Nevertheless, performance of some aspects of the routine were not consistently undertaken and cannot be clearly assessed or measured by Customs.
>
> Customs' IT systems and control arrangements provide appropriate support to intercept incoming air passengers who pose a risk or may carry prohibited items. However, IT incident and IT problem management could be improved. Further, service times for IT incidents and problems should be established and documented, especially for those with a significant business impact.
>
> Arrangements to share management information and promote cooperation between Customs and DIAC are sound, but there was no clear evidence of monitoring whether all the Key Performance Indicators (KPIs) were being met or not.
>
> The ANAO has made four recommendations to strengthen Customs' processing of incoming international air passengers. These recommendations are directed to achieving: a consistent implementation and assessment of the routine required in the primary line; an up-to-date disaster recovery plan; the consistent recording and reporting of IT incidents and IT problems; and the

regular monitoring and reporting of KPIs set out in the MoU
between Customs and DIAC.[5]

ANAO recommendations

Table 4.1   ANAO recommendations, Audit Report No. 10 2009-10

1.	The ANAO recommends that Customs and Border Protection develops a means to:
	• assure itself that key aspects of the routine required of Customs and Border Protection officers performing primary line functions are consistently implemented across all international airports; and
	• measure and report the time taken to process passengers through the primary line.
	Customs and Border Protection response: *Agreed with qualification.*
2.	The ANAO recommends that Customs and Border Protection Passengers Division's disaster recovery plan:
	• is up-to-date and reflects Customs and Border Protection's current IT business environment;
	• aligns with its current IT service provider's disaster recovery plan for Customs and Border Protection; and
	• has response times that have been tested, recorded, monitored, and updated if necessary.
	Customs and Border Protection response: *Agreed.*
3.	The ANAO recommends that Customs and Border Protection:
	• puts in place mechanisms so that the severity of IT incidents and IT problems is rated consistently;
	• establishes acceptable service times for IT incidents and IT problems;
	• monitors, tracks and links to specific recorded action times, all IT incidents and IT problems; and
	• ascertains and reports in a consistent manner the (adverse) business impact of IT problems.
	Customs and Border Protection response: *Agreed.*
4.	The ANAO recommends that in relation to its Memorandum of Understanding for the Provision of Clearance Services, that Customs and Border Protection works with the Department of Immigration and Citizenship to:
	• monitor and report against the Key Performance Indicators (KPIs) regularly; and
	• update the KPIs, if necessary.
	Customs and Border Protection response: *Agreed.*

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5   Audit Report No. 10 2009-10, pp. 12-13.

The Committee's review

4.9 The Committee held a public hearing on Thursday 11 March 2010, with the following witnesses:

- Australian National Audit Office (ANAO); and
- Australian Customs and Border Protection Service.

4.10 The Committee took evidence on the following issues:

- consistent implementation of primary line routine;
- measuring passenger queue and processing time;
- staff training and development;
- Key Performance Indicator (KPI) management;
- effectiveness of the processing system;
- appropriate processing of incoming passengers;
- reasons for referrals
  ⇒ health; and
- IT system breakdowns.

Consistent implementation of primary line routine

4.11 Customs, in association with DIAC, have specifically designed a routine for primary line officers to mitigate risks with regard to incoming passengers. The ANAO found that 'although the routine was generally adhered to across the airports, there were inconsistencies in conducting the specified routine'.[6] While acknowledging that it was difficult to measure key steps in the routine, the ANAO recommended that steps be taken to ensure the routine is implemented consistently across all international airports.[7]

4.12 In their opening statement to the public inquiry, Customs assured the Committee that steps had been taken to implement this recommendation.[8] In collaboration with DIAC, Customs are ensuring that:

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6   Audit Report No. 10 2009-10, p. 34.
7   Audit Report No. 10 2009-10, pp. 35 and 37.
8   Ms Dorrington, Australian Customs and Border Protection Service (Customs), p. 2. All references to witnesses' evidence comes from the Committee's hearing into this audit dated 11 March 2010, with page numbers relating to the Proof Committee Hansard.

- practice statements … and instructions and guidelines are reviewed and updated regularly and cleared through relevant immigration policy areas before they are issued;

- Customs components of the primary clearance course, which is delivered to our trainees, are reviewed and updated on a regular basis;

- input is sought from Immigration (on) immigration related policy matters; and

- Customs contributes to Immigration reviews and updates of their component of the primary clearance course.[9]

4.13   With regard to consistent implementation of the primary line routine, Customs advised the ANAO that it was developing a 'Quality Assurance Process' designed to assist management to determine compliance or non-compliance with the routine.[10] The Committee asked the Department what progress had been made with the development and implementation of the 'Quality Assurance Process' and whether or not it had improved compliance.

4.14   Customs told the Committee that the 'high-level details of a broader quality assurance framework' have been developed but that the 'detail for delivery and implementation' have not yet been finalised.[11] Customs added that, as part of this process:

> … a national review has been conducted to assess which operational practices should be subject to regular compliance measures. This assessment included a recommendation to develop a nationally consistent assessment and reporting process for key Airport Operations activities, including primary processing.[12]

4.15   The ANAO also noted that at the time of the audit Customs was developing a new Practice Statement Framework (PSF) to replace the existing Standard Operating Procedures (SOPs). The ANAO observed:

> Once finalised and if implemented well, the new PSF will assist Customs and Border Protection Passengers Division to perform their functions efficiently and consistently across Australia's international airports.[13]

4.16   The Committee asked Customs if the new Framework had been implemented and what results it had achieved. Customs informed the

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9   Ms Dorrington, Customs, p. 2.

10   Audit Report No. 10 2009-10, p. 35.

11   Customs, submission no. 6, npn.

12   Customs, submission no. 6, npn.

13   Audit Report No. 10 2009-10, pp. 41-42.

Committee that the PSF has been implemented and that all staff now have internet access to the Framework consisting of consistent policy and procedural documents.[14] Customs maintains:

> Use of the framework is driving national consistency of practices and procedures, and allowing details of the quality assurance framework to be developed.[15]

Measuring passenger queue and processing time

4.17   Customs has developed an internal management standard of 45 seconds based on the time passengers spend queuing for the primary line. Compliance with this cycle processing time allows Customs to meet a processing facilitation standard of clearing 95 per cent of passengers within 30 minutes of them passing through the Entry Control Point (ECP). The ANAO found the 45 second measurement arbitrary, identified inconsistencies in the way the measurement is determined and questioned its accuracy and usefulness.[16] The ANAO recommended that Customs develop a more accurate means of measuring and reporting the time taken to process passengers through the primary line.[17]

4.18   The Committee queried why Customs agreed to this recommendation with qualifications. Customs explained to the Committee that, while it is actively looking for a more accurate method to measure passenger queue and processing time:

> … the methodology that is the subject of this recommendation was put in place primarily for the purpose of resource deployment. In that sense it has been effective, and it will stay in place until we can find another, more cost-effective and accurate means to measure queue time.[18]

Staff training and development

4.19   Overall the ANAO found the training being provided to primary line officers was adequate but that, given the 'complexities and resource constraints at the airports', training was not provided consistently across airports.[19] The ANAO suggested that a program of regular assessment of

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14   Customs, submission no. 6, npn.
15   Customs, submission no. 6, npn.
16   Audit Report No. 10 2009-10, pp. 35-36.
17   Audit Report No. 10 2009-10, p. 37.
18   Ms Dorrington, Customs, p. 2.
19   Audit Report No. 10 2009-10, p. 39.

primary line officers be developed aligned with refresher training courses.[20]

4.20   The Committee asked Customs if steps were being taken to implement such a process. Customs informed the Committee that under current arrangements 'assessment and coaching are provided to specific officers' when performance standards are not met.[21] It acknowledged that the 'primary line assessment tool' is used inconsistently across airports: some airports use it to assess all staff annually before new performance agreements are established whereas other airports use it only when concerns are raised regarding an officer's performance/capability.[22] Customs told the Committee steps are being taken to develop a more consistent approach:

> Work is progressing to update the primary line assessment tool in line with current Instructions and Guidelines, determine a nationally consistent regime for conducting this assessment and a recommendation for how often refresher training should be conducted.[23]

4.21   The ANAO also found the training materials provided by Customs to be 'appropriate and relevant' but identified a lack of specific guidelines on the parameters of the 'power to question passengers'.[24] Since the ANAO findings Customs has produced training modules on *Questioning Techniques and Elements* and *Standard Questions.*[25]

4.22   The Committee asked Customs whether or not the new materials had been distributed and used in training and was told the training materials have been completed and are being delivered to all trainees. In addition, Customs told the Committee that the whole training program has been revised and a number of other modules now contain relevant material on questioning techniques.[26]

Key Performance Indicator (KPI) management

4.23   The ANAO found that, although Key Performance Indicators (KPIs) were in place through the Memorandum of Understanding between Customs

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20   Audit Report No. 10 2009-10, p. 39.
21   Customs, submission no. 6, npn.
22   Customs, submission no. 6, npn.
23   Customs, submission no. 6, npn.
24   Audit Report No. 10 2009-10, pp. 38-39.
25   Audit Report No. 10 2009-10, p. 39.
26   Customs, submission no. 6, npn.

and DIAC, a number of the KPIs were not being regularly monitored and reviewed.[27] The ANAO recommended that Customs work with DIAC to update the KPIs and monitor and report against the Indicators regularly.[28]

4.24   Customs told the Committee it is working with DIAC to prepare a report that will assess the relevance of the current KPIs and data collection methods.[29] With regard to the KPIs, Customs are working to determine:

- relevant performance information targets;
- the usefulness of the data pinpointing more systematic errors;
- a process for addressing errors; and
- an appropriate reporting and feedback mechanism.[30]

Effectiveness of the processing system

4.25   The Committee was particularly interested to know whether or not the audit had shown if the systems and controls that Customs has in place effectively support the referral of incoming air passengers who pose a risk to Australia. The ANAO confirmed that the system is working effectively. During the course of the audit the ANAO team had observed Customs officers performing the primary clearance routine across four international airports: Sydney, Melbourne, Perth and Darwin.[31] The ANAO assessed the primary clearance process and the application of the process and found both worked effectively.[32]

4.26   The Committee asked Customs how it measures the success of the system. Customs told the Committee it measures its response to the alert system: whether it has responded to the alert, if the response was appropriate and if any action taken was appropriate.[33] Customs also looks at the risk indicators it uses to identify people to be placed on the alert list and whether or not those indicators are successfully picking up passengers or crew who pose a risk.[34]

4.27   The Committee further inquired if there is any trend evident with regard to improvement in the effectiveness of the system. Customs advised that the trend is positive:

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27   Audit Report No. 10, 2009-10, p. 68-69.
28   Audit Report No. 10, 2009-10, p. 71.
29   Ms Dorrington, Customs, p. 2.
30   Ms Dorrington, Customs, p. 3.
31   Audit Report No. 10, 2009-10, p. 28.
32   Mr Cahill and Mr Clarke, Australian National Audit Office (ANAO), p. 4.
33   Ms Dorrington, Customs, p. 5.
34   Ms Dorrington, Customs, p. 5.

The ongoing trend now for some period of time is that we are more successful proportionate to the number of baggage examinations we undertake or the proportion of people we pick up at the primary line. So over a period of time we examine fewer people with a higher success rate.[35]

Appropriate processing of incoming passengers

4.28   The Committee asked if the audit had determined that incoming passengers were being processed appropriately. The ANAO was confident that passengers were being processed appropriately and defined what it considered 'appropriate':

By appropriate … we were looking to see that the agency had defined what the immigration risk was and had in place processes to identify people of immigration risk and to tell their officers what to do when those people present an immigration risk.[36]

Reasons for referrals

4.29   The Committee asked Customs for what reasons passengers and crew were referred during 2007-09 and for the outcome of the referrals. Customs supplied the Committee with the following table and indicated that, of these referrals, 1135 were refused entry into Australia. Customs informed the Committee that health referrals are referred to Australian Quarantine and Inspection Service and Customs does not record outcome details.

Table 4.2   Passenger referrals

Referral code	Short meaning	Movements
P	PAL possible match	77058
D	No Australian or New Zealand passport or no Australian visa held	69372
4	Manual (officer initiated) referral	45065
T	Bona-fides check	30255
C	No ETA/Visa record found	23710
O	Overstayer	8956
F	Australian visa held by New Zealand passport holder	4173
V	Visa ceased or cancelled	4017
7	Holder of bridging visa "E"	2900

35   Ms Dorrington, Customs, p. 5.
36   Mr Clark, ANAO, p. 6.

A	No record of Australian or New Zealand passport	1707
Z	Passport not in force/unacceptable/being processed	1031
M	Breach of condition 8504	750
W	DAL document alert	741
J	Lawful until date (LUD) invalid	700
R	Visa evidence record not found/Stay period invalid	364
Q	Impound Australian passport	362
L	Passport lost or stolen	81
I	Person on Australian or New Zealand passport not matched	54
H	Other	7

Source   *Customs and Border Protection, submission no. 6*

4.30   The Committee noted that there had been a large increase in the number of incoming international crew in 2007-08 and asked for the cause. Customs identified two reasons for the increase: more flights and vessels arriving in the country and larger aircraft and cruise ships with larger crews.[37]

Health

4.31   The Committee expressed concern that the incoming passenger card only contained questions regarding tuberculosis and yellow fever and not hepatitis B and C. The Committee asked DIAC for clarification on how the health questions on the incoming passenger card are determined. DIAC informed the Committee that the Department of Health and Ageing is the policy setting agency and 'provides DIAC with those health concerns for action during VISA screening and border crossing'.[38] With regard to hepatitis B and C, DIAC told the Committee:

> DoHA do not consider hepatitis B and C as a public health threat. The exception to this is that DoHA have agreed the need for screening for hepatitis B and C in relation to the visa applications of health care workers, working in exposure prone procedures in the health care sector. As this is a very small cohort it is not believed warranted to ask this as a routine question.[39]

37   Customs, submission no. 6, npn.

38   Department of Immigration and Citizenship (DIAC), correspondence, 24.03.2010.

39   DIAC, correspondence, 24.03.2010.

IT system breakdowns

4.32   The ANAO noted the importance of a stable IT environment to the effective operation of Customs' primary line.[40] The ANAO found the IT incident management process of Customs and Border Protection's Passengers Division to be sound but identified two areas that require improvement:

- recording IT problems and their severity ratings as accurately as possible; and
- resolving the IT problem over a reasonable period.[41]

4.33   The Committee was concerned that these difficulties may cause the IT system to be down for periods of time, seriously compromise the system and allow incoming passengers or crew who pose a risk to the Australian community to gain entry into the country. The ANAO told the Committee that the only consequence of the difficulties that it had observed was a delay in processing passengers.[42] Customs confirmed that a breakdown in the IT system will cause delays but assured the Committee that primary line officers would switch to manual processing thus ensuring the integrity of the system:

> It is not as though people can walk through the border with no record. We would fall back to manual processing and there are well-drilled protocols in place to deal with that.[43]

4.34   Customs identified the real risk when the IT systems are down as the lack of access to the Passenger Analysis, Clearance and Evaluation (PACE) system.[44]

4.35   The Committee asked the Department to quantify the IT systems failure rate, and the consequent lack of access to PACE, over the past three years and indicate the number of passengers of interest who may not have been identified. Customs explained that the audit figures were not indicative as the audit had taken place during a transition period when it was moving from one service provider to another and the system was down more often than normal.[45] Customs provided the Committee with the following figures:

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40   Audit Report No. 10 2009-10, p. 54.
41   Audit Report No. 10 2009-10, p. 62.
42   Ms Roach, ANAO, p. 6.
43   Ms Dorrington, Customs, p. 7.
44   Ms Dorrington, Customs, p. 7.
45   Ms Dorrington, Customs, p. 8.

Table 4.3   IT failure incidents

Year	Number of incidents	Passengers who matched an alert and were not identified
2007	2	1
2008	5	4
2009	7	13
2010	3	0

Source   Customs and Border Protection, submission no. 6

4.36   The Committee asked Customs for the duration of these outages. Customs told the Committee that the incidents ranged from 15 minutes to nine hours, with the average being 2½ hours.[46] The Committee asked for an indication of the number of passengers that were manually processed by primary line officers during these outages and Customs provided the following figures for the period 1 January 2007 to 1 April 2010:

Table 4.4   Passengers processed manually during outages

Year	Total air passengers at major airports	Total manually processed	During power outage	Passengers who matched an alert and were not identified as a result of a power outage
2007	23 059 327	927	0	0
2008	23 816 540	2373	0	0
2009	24 651 340	5201	540	10
2010	6 678 961	153	65	0
Total	**78 206 078**	**8654**	**605**	**10**

Source   Customs and Border Protection, submission no. 6

Conclusion

4.37   The Committee's chief concern is the effectiveness of the primary line system to ensure the referral of incoming air passengers and crew who pose a risk to the Australian community. Although both the ANAO and Customs have assured the Committee that the system is effective, the identified gaps in IT incident and IT problem management are a cause for

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46   Customs, submission no. 6, npn.

concern. The Committee urges Customs to implement the ANAO Recommendation number 3 as soon as possible in order to mitigate the risk posed by IT incidents and problems to Australia's border protection.

4.38   The Committee is aware that the ANAO has a series of audits planned to examine the secondary phase of passenger processing and the role of the AQIS and DIAC and will continue to monitor the processing of incoming international passengers by the various agencies to ensure risks to Australian security are minimised.

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Audit Report No. 15 2009-10

AusAID's Management of the Expanding Australian Aid Program

Introduction[1]

5.1   The objective of Australia's aid program (the aid program) is 'to assist developing countries to reduce poverty and achieve sustainable development, in line with Australia's national interest'.[2] In 2008-09 the Australian Government provided an estimated $3.8 billion in overseas aid.

5.2   The aid program has increased in size by 42 per cent since 2004-05.[3] Strong growth will continue to be required in order to meet the Australian Government's commitment to increase official development assistance (ODA) from 0.33 per cent of gross national income (GNI) in 2008-09, to 0.50 per cent in 2015-16.

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1   The following information is taken from Audit Report No. 15 2009-10, *AusAID's Management of the Expanding Australian Aid Program*, pp. 13-16.

2   Commonwealth of Australia 2009, *Australia's International Development Assistant Program, A Good International Citizen,* Statement by the Hon. Stephen Smith MP, Minister for Foreign Affairs and the Hon. Bob McMullan MP, Parliamentary Secretary for International Development Assistance, 12 May 2009, p. 1.

3   Real growth, adjusted for inflation. In September 2005, the Australian Government announced a doubling in the aid program on 2004 levels to around $4 billion annually by 2010. [See press Release, 13 September 2005, by Prime Minister John Howard, *Increases in overseas aid*.]

5.3   The Australian Agency for International Development (AusAID) is the main Australian Government agency responsible for managing the aid program. In 2008-09 AusAID was accountable for $3.2 billion, or 83 per cent of ODA. Other government agencies are responsible for smaller amounts of aid in areas such as defence, policing and trade.

5.4   Since 2000-01, the main source of growth in ODA has been bilateral programs of assistance (known as country program aid) planned and coordinated by AusAID. The agency is expected to remain predominant in the design and implementation of increased aid investments in the coming years.

5.5   AusAID provides advice and support to the Minister for Foreign Affairs and the Parliamentary Secretary for International Development Assistance on development policy. Australian aid policy aims to accelerate progress towards the Millennium Development Goals (MDGs),[4] and places emphasis on supporting the Asia-Pacific region. Australian Government strategies to improve aid effectiveness include a focus on partnerships with recipient country governments,[5] and publication of comprehensive information about the aid program.

5.6   The Australia Government is a signatory to the international aid effectiveness agenda, as articulated in the 2005 *Paris Declaration on Aid Effectiveness* and the 2008 *Accra Agenda for Action.* Under these agreements, Australia has made commitments to strengthen and use partner country institutions and systems (including financial systems) to deliver aid; to reduce aid fragmentation and proliferation[6] – which have imposed high transaction costs on partner governments and made aid difficult to manage; and to increase the predictability of aid flows, thereby supporting budget planning of partner governments.

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4   The MDGs set global development targets to be achieved by 2015 for poverty and hunger reduction, primary education, gender equality, maternal health and child mortality, combating disease, environmental sustainability, and global partnerships. The MDGs are drawn from actions and targets contained in the 'Millennium Declaration,' which was adopted by 189 nations and signed by 147 heads of states and governments during the United Nations Millennium Summit in September 2000.

5   This approach is illustrated by Pacific Partnerships for Development, which were launched by the Prime Minister under the 2008 Port Moresby Declaration. The partnerships jointly commit Australia and Pacific nations to achieving and assessing progress against shard goals. [Media Release from the Prime Minister of Australia, 6 March 2008, Port Moresby Declaration.]

6   In the aid context, fragmentation refers to the situation when there are many small projects being delivered; proliferation refers to the provision of aid by a wide variety of donors in relatively small amounts.

5.7   In early 2007, in response to an aid program White Paper,[7] AusAID instigated internal reforms to deliver a considerably expanded and more effective aid program. These reforms included increasing program management responsibilities of country offices (known as devolution), adoption of new arrangements for the design and delivery of aid – in line with the *Paris Declaration on Aid Effectiveness*, and implementation of more rigorous performance assessment practices. AusAID also embarked on a program to upgrade country strategies to improve the focus (or selectivity) of Australia's support to particular countries.

The Audit

Audit objective[8]

5.8   The objective of this audit was to assess whether AusAID's management of the expanding aid program supports delivery of effective aid. The audit focused on progress of AusAID's internal reforms to achieve this objective.

5.9   The audit considered critical aspects of AusAID's management of the aid program. These include: management arrangements and staff capacity; how aid investments are selected; major forms of aid or modes of delivery (being technical assistance and use of partner government systems); coordination of whole of government engagement; monitoring and evaluating aid performance; and external reporting.

5.10   The audit fieldwork was undertaken at AusAID in Canberra and three countries to which Australia is providing increasing levels of aid – Papua New Guinea, the Philippines and Vietnam. The audit methodology included a survey of AusAID staff, and analysis on the changing make-up of the aid program.

5.11   The audit did not examine AusAID's management of global programs,[9] Australian development scholarships, and AusAID's contracts with suppliers.

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7   AusAID 2006, *Australian Aid: Promoting Growth and Prosperity: A White Paper on the Australia Government's aid program.*

8   The following information is taken from Audit Report No. 15 2009-10, pp. 14-15.

9   Global programs include funding for humanitarian, emergency and refugee programs, funding for programs run by multilateral organisations such as the World Bank, Asian Development Bank, and United Nations agencies, and funding for non government organisations, volunteer and community programs.

Overall audit conclusion

5.12   The ANAO made the following overall audit conclusion:

Management of Australia's aid program is a complex undertaking – it requires engagement in multiple countries and sectors to help address difficult development challenges. The effective management of the aid program requires that AusAID develop sound aid initiatives and astutely manage their implementation, by working closely with Australian Government partners, recipient country governments, and other development stakeholders. Scaling up of Australian aid and the impetus to change how aid is delivered amplify these challenges.

The ANAO concluded that, since 2005, AusAID has managed the expansion of the aid program in a way that supports delivery of effective aid. This period has seen AusAID increase the management responsibilities of country offices, recruit additional staff and build in-house technical expertise, and strengthen monitoring and evaluation of aid – supporting delivery of more aid and improved aid effectiveness. Consistent with the international aid effectiveness agenda, AusAID has also made progress in changing the way Australian aid is delivered, by commencing to increase use of partner government systems, and working more collaboratively with other donors.

Notwithstanding this progress, the aid program is likely to double in size between 2008-09 and 2015-16, and AusAID faces considerable management challenges amidst ongoing program growth. AusAID staff are concerned about workloads and stress levels at many overseas posts and there is a shortfall of expertise in some areas; many country programs have operated without an agreed development assistance strategy; the number of aid activities under management has grown strongly – contributing to aid proliferation; and reducing reliance on traditional forms of aid is proving difficult. Resolving these issues requires a particular focus on AusAID's internal capacity and the composition of Australian assistance – to make the delivery of aid more manageable and effective.

The ANAO has made six recommendations aimed at improving AusAID's management of the aid program, and strengthening accountability for aid funding and its results. In particular, AusAID can improve management of human resources by addressing its long-standing problems with regards to the level of

staff turnover, further increasing management responsibilities of locally engaged staff, and continuing to progress workforce planning and development – thereby building internal capacity to deliver aid. Completion of country program strategies that are central to, and record, aid allocation decisions would help make Australia's increasing level of aid more focused and predictable. Further, the development of a comprehensive policy on using partner government systems to deliver assistance would facilitate increased use of these systems, thereby helping to strengthen them and providing a scalable means of delivering aid. Finally, clarification of AusAID's approach to classifying administered and departmental expenses, and improved external reporting, would help make aid program running costs more transparent to external stakeholders.

Importantly, implementation of strengthened performance assessment for aid programs and activities, and the work of the Office of Development Effectiveness (ODE),[10] are focusing the attention of AusAID's management and staff on the factors that lead to better aid outcomes. Continued improvement in monitoring and evaluation of aid is required if AusAID is to remain in a good position to meet the challenges of the coming years.[11]

ANAO recommendations

Table 5.1   ANAO recommendations, Audit Report No. 15 2009-10

1.	The ANAO recommends that, in order to better support program management, AusAID refine its approaches to human resource management, including by:
	• regularly monitoring, and analysing the key drivers behind staff turnover and developing strategies to increase the length of time staff spend in roles; and
	• increasing management responsibilities of locally engaged staff, where appropriate, including in relation to management of APS personnel.
	AusAID response: *Agreed*
2.	The ANAO recommends that, in order to make country and regional strategies more central to aid allocation decisions, and thereby improve selectivity of aid investments, AusAID:
	• completes strategies for all major country and regional programs and keeps them up-to-date; and

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10   ODE was established by the 2006 White Paper as an independent unit within AusAID responsible for monitoring the quality and evaluating the impact of Australian aid.

11   Audit Report No. 15 2009-10, pp. 15-16.

	• builds on the framework provided by Pacific Partnerships for Development, by including indicative multi-year resource allocations in all country and regional strategies. **AusAID response:** *Agreed with qualification*
3.	The ANAO recommends that, in order to facilitate increased use of partner government systems in delivering aid, and improve the effectiveness of the approaches adopted, AusAID develops policies that address: • the benefits of using partner government systems and the lessons learned to date: • how decisions to use partner government systems are reached, including thorough assessment of potential development benefits and associated risks; and • how the more significant risks of using partner government systems are managed by AusAID. **AusAID response:** *Agreed*
4.	The ANAO recommends that, in order to strengthen monitoring, evaluation and management of the aid program, AusAID: • reports on the quality of monitored aid activities against the country program objectives to which they relate; • improves the quality of data captured on how aid is delivered; • publishes management responses for all major Office of Development Effectiveness reviews; and • publishes a proposed Office of Development Effectiveness annual program of evaluations. **AusAID response:** *Agreed*
5.	The ANAO recommends that, in order to strengthen external reporting and help steer agency direction, AusAID develop additional PBS performance indicators to provide a more balanced set of measures that address a broader range of critical aspects of agency performance. **AusAID response:** *Agreed* **Finance response:** *Supported*
6.	The ANAO recommends that, to improve transparency and accountability for aid program expenditure, AusAID: • obtain clarification from the Department of Finance and Deregulation on its use of administered expenses for departmental purposes; and • if the current approach to classifying administered expenses is to be continued, disclose, in its annual report, details of the program, role and cost of APS and locally engaged staff funded from the administered appropriation, as well as travel, accommodation, information technology and other administration costs paid for from this source. **AusAID response:** *Agreed* **Finance response:** *Supported*

The Committee's review

5.13   The Committee held a public hearing on Wednesday 17 March 2010, with the following witnesses:

- Australian National Audit Office (ANAO); and

- The Australian Agency for International Development (AusAID).

5.14   The Committee took evidence on the following issues:

- local staff;

- staff turnover;

- country strategies;

- non-monitored activities;

- multi-year programming framework;

- publication of reports;

- departmental and administered expenditure; and

- microfinance.

Local staff

5.15   The ANAO commended AusAID on the employment of increasing numbers of local staff. However, the ANAO found that very few local staff are in management positions. The ANAO recommended management responsibilities for local staff, including in relation to management of APS personnel be increased.[12] The Committee asked AusAID what steps are being taken to implement this recommendation.

5.16   AusAID confirmed that local staff are being employed in broader and more senior roles and quoted the example of the Philippines where 'more than half of the staff at the portfolio manager level – the equivalent in the Public Service to an EL1 – are locally engaged staff'.[13] Numbers of local staff in management roles, including managing APS staff, are also increasing in Jakarta and Port Moresby.[14]

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12   Audit Report No. 15 2009-10, pp. 51-54 and 61.

13   Mr Clout, AusAID, p. 4. All references to witnesses' evidence comes from the Committee's hearing into this audit dated 17 March 2010, with page numbers relating to the Proof Committee Hansard.

14   Mr Clout, AusAID, p. 4.

5.17   AusAID cautioned that, unlike other multilateral agencies such as the United Nations, the agency operates under the *Financial Management Accountability Act* and the *Public Service Act* and must observe the delegations and limits of the delegations of those Acts. AusAID are still examining:

> ... how we can most effectively put senior level staff from other countries into the program in-country and give them meaningful senior management roles rather than ones that do not really operate because of limitations on their ability to approve financial spending or to make decisions and take actions under the Public Service Act delegations.[15]

5.18   The Committee asked if AusAID had encountered any problems with regard to the recruitment and retention of local staff. AusAID explained that the local labour market varies considerably across the Pacific and Asian region with large Asian cities providing a deeper and broader market and a better educated workforce.[16] AusAID added that the agency must be mindful of depleting the local labour force:

> If too many of the donors take the good staff that actually deprives the local government of capacity. In fact a lot of the local staff I have talked to about what they want to do when they finish with AusAID – to go into their government and take with them the skills they have developed with us. We think that is a good path for them to take.[17]

Staff turnover

5.19   The ANAO found staff turnover within AusAID remains high and highlighted that this problem has continued for over two decades and that over 2008 'only one in two APS staff remained in their position'.[18] The ANAO expressed concern that the doubling of the aid program between 2008-09 and 2015-16 will exacerbate the problem and increase already high staff workloads and stress levels.[19]

5.20   The Committee asked AusAID what the drivers behind the staff turnover are and what plans are in place to remedy the problem. AusAID emphasised that the agency's performance was equal to the Australian

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15   Mr Clout, AusAID, p. 4.
16   Mr Clout, AusAID, p. 4.
17   Mr Clout, AusAID, pp. 4-5.
18   Audit Report No. 15 2009-10, pp. 48 and 60.
19   Audit Report No. 15 2009-10, p. 60.

Public Service generally with regard to staff separation rates[20] and wished to clarify that the problem identified by the audit report related to staff churn, or internal movement. AusAID explained that a reconfigured HR system is allowing the agency to monitor and analyse internal staff movement more effectively.[21]

5.21   AusAID identified internal transfer at level as the most significant driver, accounting for approximately two thirds of internal staff churn.[22] The doubling of overseas postings in the last four years has also contributed to the problem as has internal promotions.[23] AusAID told the Committee that to alleviate staff churn a draft workforce plan has been developed and implemented that encourages staff to stay in their positions for at least two years.[24]

5.22   The Committee queried the lack of a contractual provision requiring staff to remain at a post for a set time. With regard to overseas postings, AusAID clarified that staff are expected to serve for two years with a possible extension for a third year.[25] However, for Canberra positions AusAID would prefer to encourage change through a clearly defined corporate policy and maintained that implementation of the policy late last year is already showing results:

> We started to put some messages out around this during the later part of last year, and from quarter one to quarter two we had a drop of over 35 per cent in internal transfers at level.[26]

5.23   The Committee acknowledges that AusAID is taking positive steps to combat the effects of staff churn on the agency but is concerned at the persistence of the problem. The Committee therefore recommends that AusAID report back to the JCPAA within twelve months of the tabling of this report on the effectiveness of the draft workplace plan in alleviating staff churn, quantifying any changes.

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20   Mr Clout, AusAID, p. 5.
21   Mr Clout, AusAID, p. 5.
22   Mr Clout, AusAID, pp. 5-6.
23   Mr Clout, AusAID, p. 5.
24   Mr Clout, AusAID, p. 6.
25   Mr Clout, AusAID, p. 6.
26   Mr Clout, AusAID, p. 6.

Recommendation 2

The Committee recommends that the Australian Agency for International Development (AusAID) report back to the Joint Committee of Public Accounts and Audit within twelve months of the tabling of this report on the effectiveness of the draft workforce plan in alleviating staff churn, quantifying any changes.

Country strategies

5.24   The ANAO identified a number of weaknesses in the selection of country aid programs and recommended that country and regional strategies be improved to assist allocation decision making.[27] The Committee noted that, in its response to this recommendation, AusAID said that the report over-emphasised the role of country strategies in aid selectivity and asked if this indicated a substantial difference in strategy perspective between AusAID and the Audit Office.

5.25   To the contrary, AusAID maintained that it did not disagree with the recommendation and that it has put in place processes to ensure that, by the end of 2010, all country programs will have completed country strategies in place.[28] AusAID explained that the qualification in the response to the recommendation was intended to clarify the point that, while the audit focused on country strategy delivery, there are parts of the aid program that fall outside the country programs and concentrate on multilateral or global issues:

> ... it was to make the point that, yes, country strategies do play the central role in the delivery of the country program, if it is a program, for example, on a thematic or issues basis or through multilaterals. That was not brought into the ambit of the audit. It was also, I think, to make the point that, while the country strategy is central to the delivery of a country program, there still needs to be flexibility in terms of changes over time, events in partner countries. It was also to make the point around not the limitations but the boundaries around multi-year commitments that we could make in terms of country programs, that in fact there was still the annual appropriation process and that, while it was possible to give indicative allocations, it needed to be kept in mind.[29]

27   Audit Report No. 15 2009-10, pp. 81-82.

28   Mr Dunn, AusAID, p. 7.

29   Mr Dunn, AusAID, p. 7.

5.26   The ANAO noted that annual performance reporting is a useful tool for
        country program managers to monitor the relationship between country
        level objectives and aid activities.[30] The ANAO maintain that, over time
        this information could:

> ... lead to establishment of more realistic objectives for Australian
> aid, and support stronger linkages between country strategies, aid
> investments and performance assessment.'[31]

5.27   However, the ANAO found that annual performance reporting is not
        being used to develop scaling up proposals or identify where additional
        resources are needed. The ANAO suggested that AusAID could make
        better use of annual performance audits to achieve aid objectives and
        drive country program coherence.[32] The Committee asked AusAID if any
        steps had been taken to implement this suggestion.

5.28   AusAID informed the Committee that new guidelines and procedures had
        been put in place to ensure greater use is made of the information from
        annual performance audits:

> New guidance has been prepared to ensure that management
> consequences identified in the annual program performance
> reports are more clearly directed towards improved program
> planning. The Operation Policy and Support Branch of AusAID
> has a performance auditing role by analysing the annual program
> performance reports, making operational recommendations that
> include scaling up options, and providing these to programs and
> the AusAID executive for review.[33]

Non-monitored activities

5.29   In 2001-02 the ANAO recommended that AusAID collect performance
        information on non-monitored activities.[34] These are activities that are
        valued at less than $3 million and account for approximately 15 per cent of
        the total of aid program funds.[35] The ANAO suggested that performance
        information on these programs would help to alleviate the problem of

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30   Audit Report No. 15 2009-10, p. 128.
31   Audit Report No. 15 2009-10, p. 129.
32   Audit Report No. 15 2009-10, p. 130.
33   AusAID, submission no. 9.
34   Audit Report No. 15 2009-10, p. 133.
35   Audit Report No. 15 2009-10, p. 133.

activity proliferation[36] by understanding the underlying drivers of this problem.[37]

5.30 The Committee asked AusAID why this recommendation had not been implemented and whether or not performance information on these smaller activities is being collected and analysed. AusAID informed the Committee that the agency has been concentrating on redesigning the performance and monitoring systems for activities over $3 million.[38] However, AusAID recognises the value of collecting such information and is currently implementing a process to collect and assess the information from a selection of projects:

> ... work is starting on a sample of non-monitored and monitored programs looking specifically at how they perform and why they continue to be delivered in their current form. This work will look at all aspects of the program and examine the process for decision making about activity selection and design, how the program is managed, where operational decisions are made, and what development impact they are having. This analysis is expected to be completed by September 2010.[39]

Multi-year programming framework

5.31 The ANAO found that, until recently, Australia did not have a multi-year programming framework in place that would provide certainty for its partner countries regarding aid flow and assist with forward planning.[40] The Committee sort assurance that the increase in the aid budget will enable AusAID to undertake long-term planning and guarantee financial and resource commitments.

5.32 AusAID confirmed the improvements to multi-year programming and cited the implementation of the Pacific Partnerships for Development model which is 'about increasing the coordination and cohesiveness of the aid effort within a country in partnership with that country, including greater certainty around resourcing'.[41]

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36   Activity proliferation refers to the provision of aid by a wide variety of donors in relatively small amounts.
37   Audit Report No. 15 2009-10, p. 133.
38   AusAID, submission no. 9.
39   AusAID, submission no. 9.
40   Audit Report No. 15 2009-10, p. 69.
41   Mr Clout, AusAID, p. 10.

Publication of reports

5.33   The ANAO noted the importance of publishing evaluations and reports for improving transparency and accountability and found that AusAID had fallen behind in this regard.[42] The Committee reiterated the importance of regular public reporting particularly as a means of monitoring performance and asked AusAID what measures it has put in place to address this issue.

5.34   AusAID assured the Committee that it has taken a number of steps to improve its publication record and bring the process up to date:

> We are certainly up to date in terms of the annual program performance reports. The Office of Development Effectiveness will be publishing a list of forthcoming evaluations. We are looking at bringing forward the timing of our annual program performance reports to make sure that they are available publicly earlier than they have been to date.[43]

Departmental and administered expenditure

5.35   The ANAO found that in recent years there has been some blurring of the classification of departmental and administered expenditure by AusAID resulting in an increase in the number of agency staff funded from administered funds.[44] The ANAO noted that this can result in a lack of transparency and accountability and recommended that AusAID seek clarification from the Department of Finance and Deregulation on its use of administered expenses for departmental purposes.

5.36   The Committee expressed concern over this development and asked AusAID if the recommendation has been implemented. AusAID told the Committee that it had sought clarification from the Department of Finance and Deregulation and that the two Departments have recently 'agreed a framework for new draft guidelines specifically for AusAID on the classification of administered and departmental expenses'.[45] It is expected that these guidelines will be finalised and implemented in the 2010-11 financial year.[46]

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42   Audit Report No. 15 2009-10, pp. 149-151.

43   Mr Dunn, AusAID, p. 11.

44   Audit Report No. 15 2009-10, pp. 157. For an explanation of why the distinction is important see Audit Report No. 15 2009-10, pp. 151-52.

45   AusAID, submission no. 9.

46   AusAID, submission no. 9.

5.37   The ANAO also recommended that, if AusAID is going to continue with its current approach to classifying administered expenses, the agency should take steps to provide greater details of these expenses in its annual report. In light of the delay of implementation of the new guidelines until the 2010-11 financial year, the Committee asked AusAID if the agency would supply greater detail of its administered expenses in the 2009-10 annual report.

5.38   AusAID assured the Committee that the agency:

> ... plans to provide information in its annual report for 2009-10 on the use of the aid budget for staff and associated costs who are directly involved in delivering the aid program to ensure transparency in the use of the aid budget.[47]

5.39   In the interests of transparency and accountability the Committee feels that it is important that AusAID clarify the classification of administered and departmental expenses and that this is accurately reflected in its annual report. The Committee therefore recommends that AusAID report back to the JCPAA within twelve months of the tabling of this report on the development and implementation of guidelines on the classification of administered and departmental expenses.

Recommendation 3

The Committee recommends that the Australian Agency for International Development (AusAID) report back to the Joint Committee of Public Accounts and Audit within twelve months of the tabling of this report on the development and implementation of guidelines on the classification of administered and departmental expenses.

Microfinance

5.40   Committee members are particularly interested in Australia's participation in microfinance programs and asked AusAID what percentage of the aid program goes to microfinance programs and which countries are targeted. AusAID replied that 0.34 per cent of official development assistance (ODA), or $13 million, of the AusAID budget is

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47   AusAID, submission no. 9.

spent on microfinance activities.[48] This figure has increased from $9.4 million in 2007-08 and is expected to increase further.[49] AusAID told the Committee that countries targeted 'broadly mirror the focus of the Australian aid program':

> AusAID supports regional and country specific programs. There are regional microfinance programs in the Pacific, and programming is underway to support a regional African microfinance program. In addition, specific countries targeted for microfinance include: East Timor, Papua New Guinea, Fiji, Vanuatu, Cambodia, Indonesia, the Philippines, Peru, Iraq, Afghanistan and Columbia.[50]

5.41   The Committee further asked what the repayment rate was like for these microfinance programs and what criteria is used to make microfinance grants. AusAID told the Committee that the 'Australian government is *not* a microfinance lender and does not provide loans and therefore does not have a repayment rate'.[51] The agency went on to explain how the Australian government facilitates microfinance programs:

> However, it does support changes needed in finance sectors to increase access to financial services such as savings and loans. Assistance is provided based on country and regional needs, AusAID's country and regional strategies and the Financial Services for the Poor Strategy.[52]

Conclusion

5.42   The Committee is concerned that the increase in staff workload and stress caused by the recent increase in the Australian aid program is going to be exacerbated by the proposed doubling of the aid program by 2015-16. The Committee acknowledges that AusAID has developed a draft workforce plan that should alleviate some of these difficulties including workplace churn. The Committee urges AusAID to implement this plan as soon as possible and ensure that it achieves positive results for staff.

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48   AusAID, submission no. 9.
49   AusAID, submission no. 9.
50   AusAID, submission no. 9.
51   AusAID, submission no. 9.
52   AusAID, submission no. 9.

5.43   The Committee stresses the importance of regular public reporting on performance to build public and parliamentary confidence in AusAID and the delivery of Australia's aid program and encourages the agency to continue to improve its publication record.

5.44   The Committee is disturbed by the possible blurring of the classification of departmental and administered expenditure and wants to see clarification of this practice.

6

Auditor Report No. 20 2009-10

The National Broadband Network Request for Proposal Process

Introduction[1]

6.1   In March 2007, the Australian Labor Party (Labor) released its broadband election policy to increase broadband internet speeds for 98 per cent of Australians by up to forty times. Labor considered that its national broadband network (NBN) would deliver significant national economic benefits and new services for the benefit of many consumers, particularly those in rural and regional areas. Labor committed that, in government, it would:

■ partner with the private sector to deliver a fibre-to-the-node (FTTN) NBN over five years to 98 per cent of the population with minimum speeds of 12 megabits per second (Mbps);

■ within a six-month timeframe, undertake a competitive assessment of proposals from the private sector to build the network;

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1   The following information is taken from Audit Report No. 20 2009-10, *The National Broadband Network Request for Proposal Process*, pp. 13-16.

- ensure competition in the sector through an open access network that provides equivalence of access charges and scope for access seekers to differentiate their product offerings;

- put in place regulatory reforms to ensure certainty for investment; and

- make a public equity investment of up to $4.7 billion.[2]

6.2   To meet the new Government's tight timeframe, the then Department of Communications, Information Technology and the Arts (now the Department of Broadband, Communications and the Digital Economy (DBCDE or the department)) provided early advice to the Government on the implementation of its broadband election commitments. The Government agreed in January 2008 to conduct a Request for Proposal (RFP) process to select a proponent(s) to build, operate and maintain the NBN. The Government's broadband policy reflected its election commitments, but broadened the technology choice to any fibre-based solution (using FTTN or fibre-to-the-premises (FTTP) architecture). Further, it did not specify a preferred form for the Government's investment in the network, that is, the contribution could have been as an equity investment or some other form of funding. In parallel with the NBN RFP process, the Government invited proponents, industry and public interest groups to provide submissions to the Commonwealth on regulatory issues associated with a fibre-based network, including consumer safeguards.

6.3   There was significant public and industry interest in the NBN RFP process and its potential outcome. The department assessed the potential for litigation during the process and at its conclusion as high. Consequently, the department identified the need for the process to be conducted within a strong probity framework and for decisions to be informed by appropriate specialist advice. In the first half of 2008, the department progressively engaged specialist advisers to assist in developing and conducting the RFP process, including: probity adviser; investment, financial and commercial adviser; technical adviser; legal adviser; and regulatory economic adviser.

6.4   On 11 March 2008, the Minister announced the membership of the Panel of Experts (Panel), chaired by the department's then Secretary, that would assess the NBN proposals and put forward recommendations to the

2   Australian Labor Party 2007, *New Directions for Communications: A Broadband Future for Australia – Building a National Broadband Network*, pp. 4 and 19. Before the 2007 election, the current Minister for Broadband, Communications and the Digital Economy also announced (while in Opposition) a six-month timeframe to undertake the competitive assessment process.

Minister for the preferred proponent(s). The Minister also invited industry and public submissions to assist in the development of the RFP document. The RFP document was approved by the Minister and released on 11 April 2008. The document expressed the Government's broadband policy parameters as criteria against which proposals would be assessed, rather than as mandatory requirements. The RFP sought both national proposals and State/Territory-based proposals, covering individual States or Territories, as part of a national solution. Potential proponents were required to meet pre-qualification requirements by 23 May and lodge proposals by 25 July 2008. A subsequent addendum to the RFP process extended the closing date to 26 November 2008.

6.5   Eight parties met pre-qualification requirements[3], although one party subsequently withdrew. The department and the proponents held four rounds of bilateral meetings between June and November 2008 to outline the progress of proposal development, and to clarify aspects of the RFP process and its requirements.

6.6   On 26 November 2008, proposals were received from six proponents – four national proposals and two State/Territory-based proposals. The national proposals generally put forward FTTN as the principal technology for providing connections to premises. The department determined that five of the six proposals met the RFP's minimum conditions for participation, and these proposals proceeded to the assessment phase. Telstra's proposal was excluded from the RFP assessment process because it did not meet minimum conditions for participation. The proposal did not include a Small and Medium Enterprise (SME) Participation Plan.[4]

6.7   On 20 January 2009, the Panel's Evaluation Report to the Minister advised that the three remaining national proposals had been assessed in accordance with the RFP document and that none offered value for money for the Commonwealth. The panel further concluded that there was no prospect that the proponents would be able to refine their proposals sufficiently to provide value for money. As a consequence, and in accordance with the RFP document, the Panel's assessment of

3   To be eligible to lodge a proposal, potential proponents were required to lodge with the department a $5 million bid bond and sign a confidentiality agreement by 23 May 2008. For ease of reference, those potential proponents that met pre-qualification requirements have been referred to as proponents in the report.

4   The RFP minimum conditions of participation were that proposals: be in English; use Australian legal units of measurement; include a completed and signed proponent's declaration; meet the conditions relating to the submission of multiple proposals; and include a SME Participation Plan.

State/Territory-based proposals did not proceed beyond a preliminary review. In conjunction with its Report, the Panel submitted separate advice to the Minister on how the Government's objectives might be achieved outside the parameters of the RFP. Its primary proposition was that FTTP was a preferable, albeit more costly, technology to FTTN, and that the Government should explore incentive schemes to encourage the roll-out of FTTP.

6.8 On 7 April 2009, the Minister terminated the RFP process. All proponents were immediately advised of the Minister's decision and the Government's new policy approach. The Prime Minister, the Treasurer, the Minister for Finance and Deregulation and the Minister jointly announced the establishment of a new company to build and operate a new super-fast NBN (National Broadband Network Company Ltd). At the same time, the Minister released the Panel's observations from the Evaluation Report. The Panel observed that each proposal contained attractive elements and, collectively, they provided a good evidence base for the Government to move its policy agenda forward. The Panel also observed that:

- proposals lacked committed private sector funding;

- none of the national proposals was sufficiently well developed to present a value-for-money outcome;

- no proposal submitted a business case that supported the roll-out in five years of a NBN to 98 per cent of Australian homes and businesses with a Government contribution of $4.7 billion;

- FTTN is unlikely to provide an efficient upgrade path to FTTP;

- there was a risk of liability to pay compensation to Telstra for exclusive or near-exclusive access to Telstra's customer access network; and

- proponents sought excessive regulatory restrictions on competitors building and operating their own fibre-based networks in competition with the NBN (that is, overbuild protections).

6.9 The department offered oral debriefings to all proponents that met the minimum conditions for participation and returned bid bonds to all proponents, although there was some delay in one instance.

The Audit

Audit objective[5]

6.10   On 21 April 2009, Senator the Hon. Nick Minchin, then Shadow Minister for Broadband, Communications and the Digital Economy, wrote to the Auditor-General requesting consideration be given to conducting an audit of the NBN RFP process. Issues raised included the outcome of the process; whether amendments were made to the RFP documents relating to non-compliant bids; Telstra's exclusion from the process; the costs associated with the RFP process for both the Government and bidders; and the refund of bonds paid to bidders.

6.11   After conducting a preliminary review, the Auditor-General decided to undertake a performance audit into the NBN RFP process. The objective of the audit was to examine key aspects of the process, including:

- the background to and conduct of the RFP process;

- management of key risks associated with the process and outcomes; and

- stakeholder consultations.

6.12   The audit examined DBCDE's management of key aspects of the:

- implementation of the NBN RFP process from the time of the election of the new Government on 24 November 2007 to the release of the RFP document on 11 April 2008; and

- conduct of the NBN RFP process after the release of the RFP document to the termination of the process on 7 April 2009.

Overall audit conclusion[6]

6.13   Labor went to the Federal Election in November 2007 with a commitment to create a national FTTN broadband network, with construction to begin by late 2008. Following the swearing in of the new Government in December 2007, the department gave priority to developing and implementing this election commitment. The Government's approach was to pursue a process that maximised competitive tension between potential proponents and promoted innovation to achieve the best outcomes and

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5   The following information is taken from Audit Report No. 20 2009-10, pp. 16-17.

6   The following information is adapted from Audit Report No. 20 2009-10, pp. 17-23,

best use of up to $4.7 billion in government funding. It has been generally acknowledged within the telecommunications sector that this amount was the level of funding sought by Telstra from the former Government in 2005 to upgrade its equipment to build a FTTN network covering 98 percent of Australia's homes and businesses at speeds of 12 Mbps.

6.14   After considering advice on the pros and cons of conducting the process in one rather than two stages, the Government concluded that a one-stage process was appropriate and its risks could be managed. The alternative, adopting a multi-stage process, would have been the more conventional approach for conducting tender processes of this size, nature and risk, particularly when seeking innovative solutions. Proponents contacted by the ANAO considered that the two-way dialogue an expression of interest stage in a two-stage process generates, would have better informed the RFP process and the RFP document, increasing the likelihood of a successful outcome. The main disadvantage of multi-stage tendering is the additional time required to approach the market, or particular proponents, more than once, which was a factor considered by the Government given the tight timeline envisaged for the assessment process.

6.15   The department identified the likelihood of many of the key risks to a successful outcome to the RFP process when assisting the Government to settle the details of its broadband policy, although some were not fully analysed at the time. These risks included the sufficiency of government funding to attract commercially-viable proposals capable of acceptance, the potential payment of 'just terms' compensation to Telstra for the compulsory acquisition of the right to use its assets should a non-Telstra proposal be successful,[7] and the uncertain regulatory environment. The primary means of addressing these and other risks was to design the RFP process to maximise flexibility, minimise mandatory requirements and allow proponents to offer innovative solutions.

6.16   National proponents were asked to submit binding proposals against the 18 Commonwealth objectives for the NBN and other evaluation criteria, and outline the regulatory changes necessary to facilitate their proposals. The process left open the prospect that a proposal may be acceptable even though it did not meet all objectives and criteria. The competitive assessment process was expected to determine the NBN that the market could build and operate. Although the RFP document met the requirements of the Commonwealth Procurement Guidelines (CPGs), there was insufficient time to fully address specialist advisers' concerns

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7   Section 51 (xxxi) of the Australian Constitution provides the Parliament with the power to make laws with respect to the acquisition of property on just terms.

that a lack of detail in the RFP put at risk attracting binding offers. Nevertheless, the RFP document was drafted so that it could be varied to address risks and issues as and when they arose during the process.

6.17   Throughout the process, the department kept the Minister informed of progress, including:

   ■ updated appraisals of most risks to the process, and the likelihood of a successful outcome;

   ■ possible scenarios including their likelihood and consequences; and

   ■ summarised feedback from proponents on the elements likely to feature in their proposals and the challenges posed by the RFP.

6.18   After the announcement of the RFP process, potential proponents were initially concerned that the proposed timeframe would be insufficient to prepare and lodge fully developed proposals. However, the proponents considered that their concerns were addressed when the RFP timeline was extended to allow them time to consider carriers' network information. Proponents advised that the RFP's flexibility gave them significant scope to submit eligible proposals with innovative technical solutions. However, they found it difficult to develop competitive and commercially-viable proposals that would be acceptable to the Government, while not necessarily meeting all the objectives and other criteria.[8]

6.19   Proponents requested guidance on the relative importance of the Commonwealth's objectives, evaluation criteria and the regulatory changes that would (or would not) be accepted. However, as the Government had no determined preference for the NBN within its stated objectives, further advice on these issues was not forthcoming beyond that included in the RFP document. As a consequence, proponents found the bilateral meetings with the department and its specialist advisers of limited value. State/Territory-based proponents considered that the late clarification of the way their proposals would be assessed under the RFP disadvantaged their proposals and, if received earlier, may have influenced their decision to participate in the RFP process.

6.20   The RFP document saw FTTP as the future platform of the network to meet future customer demand and service developments to at least 2020

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8   The objectives were competing and, at times, conflicting. For example, the RFP asked proponents to build and operate an NBN that: covered 98 per cent of all Australian homes and businesses; offered speeds of 12 Mbps; enabled low access prices while allowing proponents to earn a return on investment commensurate with risk; and provided the Commonwealth with a return on its investment (Objectives 1, 2, 11 and 13).

and beyond. However, after the RFP had been issued, the department received unsolicited advice from the Australian Competition and Consumer Commission that FTTN was not a stepping stone towards FTTP. Most FTTN expenditure would be on equipment that becomes obsolete under a FTTP network platform. A FTTN network could also serve to delay FTTP if the successful proponent was not under significant competitive pressure and could therefore delay further investment until they had fully recovered their initial investment.

6.21   As the RFP open period progressed, it became increasingly obvious to the department that the likelihood of a successful outcome was reducing. Initially, the department and its advisers considered offers capable of acceptance, necessitating some form of 'second stage'. In mid-August 2008, the department first noted possible options for progressing the Government's broadband policy within, subsequent to, or outside of, the RFP process. By late-October 2008 and prior to the RFP closing date, alternative methods of delivering the Government's broadband policy began to be looked at more formally, should the RFP process not result in any acceptable proposals. By this time, it had become apparent that:

- the global financial crisis was having an adverse impact on proponents' ability to attract funding for their investment in the NBN;

- Telstra was seeking certain assurances from Government, including in relation to the confidentially of its bid information and potential regulatory solutions, before committing to lodging a proposal;

- some members of one pre-qualified consortia announced their withdrawal from the consortia; and

- non-Telstra proponents were unlikely to propose a national technical solution that would not require Telstra's equipment, or submit a viable business model that took into account potential compensation to Telstra of some billions of dollars for the compulsory acquisition of the right to use its equipment.[9]

6.22   Although not guaranteeing a successful outcome, the flexibility within the RFP process meant that the Government could have varied the RFP document and process when it became apparent that:

- proponents were looking for clearer direction and were unlikely to submit proposals that met all the Commonwealth's objectives and other evaluation criteria; and

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9   The ANAO has not disclosed the range of potential compensation in view of the commercial sensitivities attaching to such estimates.

- the global financial crisis was affecting the proponents' ability to finance their proposals.

6.23   Proponents would have had an opportunity to submit better developed and more competitive proposals had they received:

- greater clarity as to how the information requested was to be used when assessing proposals against the RFP's multiple objectives and criteria;

- guidance as to the relative importance of the evaluation criteria and Commonwealth's objectives; and/or

- a clearer understanding of the Government's regulatory intent for the NBN.

6.24   Providing the clarity and guidance proponents sought would most likely have necessitated an extension to the Government's timetable for the RFP process.

6.25   The NBN evaluation plan, which was approved by the Panel and the Minister before the closing date for proposals, comprehensively set out the assessment process and aligned with the RFP document. Nevertheless, its development proved to be a complex and time-consuming exercise. The Panel, assisted by the department, specialist advisers and other Australian Government departments and agencies, assessed NBN proposals in accordance with the evaluation plan. The then Secretary's decision to exclude Telstra's 12-page proposal from the assessment process was informed by comprehensive legal advice. The Panel assessed the remaining national proposals against the six evaluation criteria and determined that nearly all criteria were either met to a marginally acceptable standard or failed.

6.26   The ANAO found that conclusions and recommendations in the Panel's Evaluation Report were supported by appropriate evidence. The Panel's published observations of the process generally represented the reasons for the non-selection of a national proponent, as well as providing some advice to the Government on policy options for going forward. In separate advice to Government at the conclusion of the Panel's role in the RFP process, the Panel identified FTTP as the preferred technology for the NBN. Although more expensive, the Panel identified a number of 'hidden' costs in FTTN proposals, including potential compensation to Telstra, risk of obsolescence and reduction in competition through requested regulatory changes.

6.27 The Government's choice of a fibre-based technology platform for the NBN and the quantum of government funding available to the successful proponent(s) meant that Telstra's assets, including its customer access network and ducts from the exchange, were a critical dependency for the success of the NBN RFP process. It was generally accepted that the only other technology for a national fibre-based network, FTTP, would require a significantly greater government contribution to be commercially viable. Analysis by DBCDE as the RFP progressed determined that, although a FTTN network could co-exist with copper-based broadband networks, the amount of government assistance on offer meant it was unlikely to be commercially viable for reasons that included its ability to attract enough customers to cover its costs and that it would still require access to Telstra's customer access network.

6.28 As a consequence, Telstra was inherently well-placed to lodge a competitive (and potentially successful) proposal. Non-Telstra proposals were likely to present significant risks, including:

- the payment of substantial levels of compensation to Telstra for the compulsory acquisition of the right to use its assets; and

- potential regulatory changes that would restrict other entities (mainly Telstra) building a parallel fibre-based broadband network (which could be inconsistent with Australia's international trade obligations, and therefore at odds with the Government's broadband policy).

6.29 Despite the RFP process's complexity and short timeframe, the ANAO found that the Panel and the department conducted the formal process well, within the parameters of the Government's broadband policy and in accordance with the CPGs. As the RFP process progressed, the department advised the Minister that the prospects of a successful outcome were reducing. At the end of the RFP process, there were no successful proposals.

6.30 The RFP process has come at a significant cost to the Government and proponents, with costs incurred being in excess of $30 million. DBCDE's costs were some $17 million and the proponents' costs (where advised) ranged between $1 million and $8 million. In reviewing the process employed and in light of the outcome, the ANAO made a number of observations:

- early in the process, most NBN stakeholders considered that a two-stage process to select proponent(s) for the NBN would have improved the prospects of a successful outcome and may have reduced proponents' costs;

- requesting proponents to outline their preferred regulatory environment for their NBN was unusual for an RFP process and made a complex commercial transaction considerably more complicated;

- the global financial crisis significantly reduced the prospects of a successful outcome by affecting the viability of the proposed NBNs; and

- using FTTN technology for the network limited its potential scalability.[10]

6.31   The department informed the ANAO that the Government was made fully aware of all of the key risks and their significance for a successful outcome to the RFP process. The ANAO found that while it is the case that the key risks and their broad significance were identified in early advice to the Government, the department did not fully assess the consequences of some of these risks until relatively late in the RFP process. These included, in particular, the possible magnitude of: the potential payment of compensation to Telstra should a non-Telstra proposal using FTTN technology be successful; and the consequences for investment in FTTN equipment, which largely would become obsolete, should the network be upgraded to FTTP technology. The design of the Government's approach to the market would have been better informed had the department provided timely advice on these issues ahead of the RFP process being settled.

6.32   As it was, the Government decided to seek binding offers from the market through a one-stage RFP process and give proponents wide scope to request regulatory changes to facilitate their proposals. This approach was not conventional for a competitive assessment process of this size, nature and risk. Given the amount of government funding on offer, Telstra was the proponent most likely to be in a position to build and operate a viable fibre-based NBN. The likely impact on the prospects of a successful RFP outcome had Telstra lodged an eligible proposal, is indeterminate. As the outcome of the RFP process showed, no other proponents were successful either.

6.33   The audit did not make any recommendations to the department as the RFP process had been finalised. Nevertheless, the audit emphasises the importance of departments gaining, as early as possible, a sound understanding of the implications of those risks that are critical to the success of major tender processes, amongst the many risks that are

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10   Audit Report No. 20 2009-10, p. 22.

required to be managed. This is particularly challenging in a one-stage process that is seeking binding offers.

The Committee's review

6.34   The Committee held a public hearing on Thursday 11 March 2010, with the following witnesses:

- Australian National Audit Office (ANAO); and

- Department of Broadband, Communications and the Digital Economy (DBCDE).

6.35   The Committee took evidence on the following issues:

- identification and evaluation of risk:

- specialist advisers;

- the reducing likelihood of a successful outcome;

- options to change RFP;

- Telstra's bid; and

- lessons learned.

Identification and evaluation of risk

6.36   The ANAO found that the DBCDE had conducted the RFP process well, within the parameters of the government's broadband policy and in accordance with the Commonwealth's procurement guidelines.[11] The ANAO also found that the department identified the 'key risks and their broad significance 'early in the process and advised the Government accordingly.[12] However, the ANAO found that the department had not assessed the impact of two of those risks until relatively late in the process:

- the potential payment of compensation to Telstra should a non-Telstra proposal using FTTN technology be successful; and

- the consequences for investment in FTTN equipment, which largely would become obsolete, should the network be upgraded to FTTP technology.[13]

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11   Audit Report No. 20 2009-10, p. 22.

12   Audit Report No. 20 2009-10, p. 23.

13   Audit Report No. 20 2009-10, p. 23.

6.37   The ANAO identified the first of these, the amount of compensation that may have to be paid to Telstra, as a significant key risk. While the ANAO acknowledged that the department had kept the Minister and the Government fully informed of the possibility of this risk throughout the process, it considered that an attempt should have been made earlier in the process to quantify the risk.[14] The ANAO maintained that:

> … earlier advice to Government on the possible magnitude of the potential Telstra compensation would have provided the Government with a greater appreciation of the consequence of this key risk, including its relativity to the likely cost of the network, and potential impact on a successful outcome. This information would have better informed, and may have influenced, the Government's approach to delivering the NBN.[15]

6.38   In its written response to the Audit Report the DBCDE said that estimating a compensation figure early in the process was problematic for a number of reasons:

> Until there was some measure of clarity as to both the intended approach of non-Telstra proponents to utilising Telstra infrastructure and to the proposed arrangements to recompense Telstra for that use, meaningful compensation estimates could not be developed.[16]

6.39   The Committee requested further explanation as to why DBCDE were reluctant to quantify the risk earlier and provide more specific advice to the Government. The department defended its position, telling the Committee that, in hindsight, it is easy to speculate that the process could have been handled differently but at the time a reliable compensation assessment could not be undertaken until the proposals were received.[17] To have any level of accuracy, a compensation estimate would have to take into consideration what proponents were proposing:

> … it was very difficult to assess the compensation without fully understanding the extent to which proponents were proposing to make use of Telstra's network and the extent to which they were proposing to pay Telstra for using that infrastructure. We certainly had proponents who were representing to us that they considered

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14   Audit Report No. 20 2009-10, p. 58.

15   Audit Report No. 20 2009-10, p. 58.

16   Audit Report No. 20 2009-10, Appendix 1, p. 93.

17   Mr Harris, Department of Broadband, Communications and the Digital Economy (DBCDE), p. 15. All references to witnesses' evidence comes from the Committee's hearing into this audit dated 11 March 2010, with page numbers relating to the Proof Committee Hansard.

that they were intending to pay Telstra for access to their
infrastructure [an amount] that would be sufficient to mitigate
their compensation risks and we had other proponents who were
indicating to us that they had technology solutions that meant that
the compensation would not become payable because it would not
be a mass cutover, so it would be done on a customer choice
basis.[18]

6.40   The Committee asked at what date DBCDE were able to quantify the
        compensation risk to Telstra. The Department told the Committee that in
        September 2008 the direction being taken by non-Telstra proponents was
        becoming clearer and Frontier Economics was able to develop
        'preliminary estimates of the ranges of compensation that might be
        payable to Telstra' under a variety of scenarios.[19]

6.41   The Committee acknowledged that the Department had informed the
        Minister of the potential risk posed by a compensation payment to Telstra
        in the Department's Incoming Government Brief and continued to
        scrutinise this area of risk at regular briefings with the Minister.[20]
        However, the Committee asked when the Minister had been advised of
        the possible amount of the compensation risk and DBCDE informed the
        Committee that the advice from Frontier Economics was 'incorporated in
        subsequent documents and presentations prepared for the Minister' after
        the Department received the report in September 2008.[21]

Specialist advisers

6.42   The ANAO found that DBCDE had engaged a number of specialist
        advisers to provide 'commercial, technical, economic, regulatory and legal
        advice during the competitive assessment process for the NBN' in line
        with the Commonwealth Procurement Guidelines (CPGs).[22] However, the
        ANAO noted that the advisers were not appointed until mid-March
        2008.[23] The ANAO points out that this was less than one month before the
        release of the RFP and allowed little time for the draft RFP document to be
        scrutinised by the specialist advisers or the department to revise the
        document in light of the advisers' comments.[24]

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18   Ms Cullen, DBCDE, p. 16.
19   DBCDE, submission no. 10, p. 4.
20   DBCDE, submission no. 10, p. 3.
21   DBCDE, submission no. 10, p. 4.
22   Audit Report No. 20 2009-10, pp. 44-45.
23   Audit Report No. 20 2009-10, pp. 45 and 48.
24   Audit Report No. 20 2009-10, pp. 48 and 51.

6.43 The Committee expressed concern that the lack of timely expert appraisal may have adversely affected the advice provided to government, particularly with regard to risk. The ANAO suggested that the delay in appointing the expert advisers may have contributed to not providing risk assessment earlier and considered that DBCDE could have sought outside expert legal advice earlier, specifically on the compensation risk to Telstra.[25] Such an expert could have drawn on available information to provide an estimate to Government that 'could have been updated over time when better information became available on compensation factors'.[26]

6.44 The Department maintained that there was sufficient expert advice available but conceded that the timeframe was shorter than normal for an RFP process.[27]

Reducing likelihood of a successful outcome

6.45 The Committee asked the ANAO when, from the audit, it had become clear that the RFP process would not produce a successful outcome. The ANAO replied that the Department had informed the Minister in July 2008 that there may need to be more that one stage to the process and that:

> … in mid-August (2008) the department first noted there were possible options they were putting forward. By late October (2008) alternative methods were being looked at as to how the process may continue …[28]

6.46 The Committee asked DBCDE to clarify why the process was continued after July 2008 when it became clear that the chance of a successful outcome was unlikely. The Department explained that at that stage a bid from Telstra was still possible which could provide a successful outcome and that:

> … the minister had a view that notwithstanding that there was a chance that it would not result in a successful proposal that he wanted the process to continue so that we actually could test the market.[29]

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25 Mr Cahill, ANAO, p. 17; Audit Report No. 20 2009-10, p. 57.
26 Audit Report No. 20 2009-10, p. 57; Ms Cass, ANAO, p. 17.
27 Mr Harris, DBCDE, pp. 17 and 20.
28 Ms Cass, ANAO, p. 24. See also Audit Report No. 20 2009-10, p. 82.
29 Ms Cullen, DBCDE, p. 25.

6.47   The ANAO added that the process had not 'failed' even though there had been no successful tenderer as:

> The process was followed in accordance with the Commonwealth procurement guidelines. The evaluation was done correctly, the process was done correctly. There was no successful outcome, because none of the proponents met the criteria or the objectives.[30]

Options to change RFP

6.48   In light of the reducing likelihood of a successful outcome, the Committee asked DBCDE if it had considered changing the RFP. The department said it had the flexibility to amend the process but that such change presents problems as it can have a significant impact on proponents.[31] DBCDE explained that, if such a change is contemplated, the proponents would need to be invited to 'discuss the possibility of amending the process and ask[ed] for impact assessments'.[32]

Telstra's bid

6.49   The Committee asked the ANAO if the risk of Telstra not submitting a proposal had been identified and, if so, at what stage of the process. The ANAO found that early in the process there was an expectation that Telstra would lodge a proposal. It was not until approximately one month before the closing date for submissions that DBCDE became aware that Telstra 'may decide to withdraw from the process'.[33]

6.50   DBCDE noted that Telstra did put in a proposal but that the proposal did not meet the minimum mandatory requirements and was subsequently excluded from the process.[34] The Committee queried whether or not Telstra had been asked why it had submitted an incomplete proposal. DBCDE told the Committee that, as the Telstra proposal did not comply with the minimum mandatory requirements it was not assessed.[35] The

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30   Ms Cass, ANAO, p. 27.

31   Mr Harris, DBCDE, p. 33.

32   Mr Harris, DBCDE, p. 33.

33   Ms Cass, ANAO, pp. 27-28. See also Audit Report No. 20 2009-10, p. 79.

34   Mr Harris, DBCDE, p. 28. The minimum mandatory requirements for a proposal were: the proposal should be in English, use Australian legal units of measurement, include a completed and signed proponent's declaration, meet the conditions relating to the submission of multiple proposals and include a Small Business Enterprise (SME) Participation Plan.

35   Ms Cullen, DBCDE, p. 29.

Department added that it had taken legal advice from six separate sources before making the decision to exclude the proposal.[36]

Lessons learned

6.51   The Committee asked the ANAO what lessons could be learned from the NBN RFP process with regard to mitigating both foreseen and unforeseen risks. The ANAO reaffirmed the findings of the audit, emphasising the need for early identification of risks:

> … the importance of departments gaining, as early as possible, a sound understanding of the implications of those risks that are critical to the success of major tender processes, amongst the many risks that are required to be managed. This is particularly challenging in a one-stage process that is seeking binding offers.[37]

6.52   The Committee asked DBCDE if it had undertaken a review in light of the audit findings and if there had been any changes to protocols. The Department reiterated that the audit report had found that DBCDE had run the process well, conforming to the Commonwealth Procurement Guidelines. DBCDE added that it has held discussions with other departments and with the Auditor-General regarding the difficulties inherent in varying a process once it has begun:

> I have said to the agencies involved that the greatest difficulty we have here is the need to effectively [give] permission to take risk. It is actually risk inside the process. … if part of the way through the process you think, 'It's a judgement call but it's likely that the proponents will (not be) able to satisfy us, should we pull the plug, should we vary it?' that is actually a very difficult proposition because of the response of proponents. In other words, one or two proponents might be very happy for you to alter this and others will be very angry with you.[38]

Conclusion

6.53   Considering the size of the budget for this project and the apparent lack of a positive outcome, the Committee shares the ANAO concerns regarding

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36   Ms Cullen, DBCDE, p. 29.

37   Audit Report No. 20 2009-10, p. 23.

38   Mr Harris, DBCDE, pp. 34-35.

risk management for the project. The Committee encourages all agencies and departments to ensure that risks are identified early in the tender process and, where possible, quantified.

7

Audit Report No. 26 2009-10

Administration of Climate Change Programs

Introduction[1]

7.1   The Australian Government has indicated that climate change, caused by the emission of anthropogenic greenhouse gases, is an important issue that has the potential to cause significant damage to our environment, industries, people and infrastructure. The Department of Climate Change and Energy Efficiency (DCCEE) has stated that some degree of change to our climate will be unavoidable because of the level of gases already accumulated in the atmosphere. DCCEE claims that as a consequence, there will be a greater likelihood of more frequent and more extreme weather events including heat waves, storms, cyclones and bushfires; a continued decline in rainfall in southern Australia; and higher temperatures leading to decreases in water supplies.[2]

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1   The following information is taken from Audit Report No. 26 2009-10, *Administration of Climate Change Programs*, pp. 11-15.

2   Department of Climate Change and Energy Efficiency, Adapting to Climate Change [Internet] Canberra, January 2010, available from
<http://www.climatechange.gov.au/en/government/adapt> (accessed 19 March 2010).

Australian Government response to climate change

7.2   In response to the challenge posed by climate change, successive
         governments have used grant and rebate programs as a vehicle for
         reducing national emissions and to stimulate more renewable energy
         sources such as solar, wind, geo-thermal and hydro technologies.
         Investment in research and development and the commercialisation of
         other new technologies, such as carbon capture and storage, has also been
         a feature of the policies of the present and previous governments.

7.3   The current Australian Government has committed more than $15 billion
         towards climate change initiatives. The Government's actions on climate
         change fall under three main categories, referred to as the *Three Pillars
         Strategy*. These are:

         ■ reducing emissions;

         ■ adapting to unavoidable climate change; and

         ■ helping to shape a global solution.

7.4   The ANAO examined a sample of three grant programs and two rebate
         schemes, valued at $1.7 billion, which were designed to reduce
         greenhouse gas (GHG) emissions, and to promote or demonstrate
         renewable energy technologies. These programs were chosen as they were
         significant, high profile measures from the suite of 62 Australian
         Government climate change programs in place at the time. Table S1
         outlines the five climate change mitigation and industry development
         programs examined as part of this audit, the funds appropriated and the
         agencies that were responsible for administering the programs.[3]

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3   The management of LETDF was transferred from the Department of Innovation, Industry,
    Science and Research to the Department of Resources, Energy and Tourism from 1 July 2008.
    Prior to November 2007, the program was administered by the then Department of Industry,
    Tourism and Resources.

Table 7.1   Climate change mitigation and industry support programs examined as part of the audit

Department	Relevant programs	Total budgeted funds ($m)	Type of program
The Environment, Water, Heritage and the Arts (DEWHA)[4]	Greenhouse Gas Abatement Program (GGAP)	400.0	Grant
	Solar Cities	93.8	Grant
	Solar Homes and Communities Plan (SHCP)	286.5	Rebate
	Renewable Remote Power Generation Program (RRPGP)	399.1	Rebate
Resources, Energy and Tourism (DRET)	Low Emissions Technology Demonstration Fund (LETDF)	500.0	Grant
Total		**1679.4**	

Source: Budget funds based on Annual Reports from DEWHA and DRET

7.5   Applications for these programs have closed and future funding rounds are not anticipated. Apart from SHCP and RRPGP, no funding has been allocated in the forward estimates to cover additional funding commitments. Ongoing funding commitments will be progressively met under the existing contractual arrangements specified in the deeds of agreement for each program. This is likely to extend the Commonwealth's financial commitment up to 2020.

7.6   SHCP, Solar Cities and RRPGP are now being administered by DCCEE and LETDF by DRET.[5] SHCP and RRPGP have been replaced by the Solar Credits initiative, which is also being administered by DCCEE. In addition, a $3.9 billion *Energy Efficient Homes Package* announced in the 2009-10 Budget provides incentives for households to improve their energy efficiency through installing insulation and solar hot water systems. These programs have some similarities with the SHCP in that demand forecasting is critical to the effective management of appropriations. Assistance for renewable energy and clean coal technology will now be provided through the Clean Energy Initiative, which was announced in the May 2009 Budget.

7.7   The findings from this audit have been designed to assist in the implementation of these and future programs as well as convey lessons

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4   The programs administered by DEWHA were transferred to DCCEE in March 2010.

5   Funding for GGAP has been fully expensed.

that may have application to other grant programs in the departments concerned.

Projects funded under grant programs

7.8   Funding under the competitive grant programs has been for projects such as large scale demonstration projects supporting new technologies to reduce GHG emissions. Grants have ranged from $1 million to $100 million and recipients have tended to be large private, industrial or resource companies, or consortia of governments, industry and community organisations. The following are examples of projects and the programs under which they are funded:

- reductions in emissions of synthetic GHG gases from refrigeration systems in supermarkets (GGAP);

- retro-fitting a set of new technologies to an existing coal-fired power station in Queensland to trial carbon capture and storage (LETDF); and

- Adelaide Solar City (Solar Cities program) to establish and trial innovative technologies and practices, including the concentrated uptake of solar power, energy efficiency and smart metering technologies.

Rebate schemes

7.9   The SHCP provided rebates of up to $8000 dollars ($8 per watt up to one kilowatt)[6] to homeowners for the installation of solar photovoltaic systems on their principal place of residence, and rebates to community organisations that installed photovoltaic power systems for educational purposes.

7.10   Funding for RRPGP provided financial support to increase the use of renewable generation in remote parts of Australia that relied on fossil fuel for electricity supply. The program has three main components: Renewable Energy Water Pumping Rebates, Residential and Medium-scale projects and Major projects. Since the start of the program in 2000, over 6500 small rebates have been paid with the installation of more than 9400 kilowatts of photovoltaic, wind and micro-hydro generation under the Renewable Energy Water Pumping and Residential Medium-scale

6   The original rebate was revised from $2.50 per peak watt in September 2000 to $5.50 per watt. This was then revised down to $4 per watt in May 2003. In May 2007, the rebate was doubled to $8 per watt.

projects. For major projects, over $52 million has been approved for 31 projects, of which 20 have been completed.[7]

Previous Audit

ANAO Audit Report No. 34 2003-04, *The Administration of Major Programs*

7.11   Audit Report No. 34 2003-04 examined a sample of Australian Government programs, valued at almost $900 million, administered by the then Australian Greenhouse Office (AGO). The report identified administrative weaknesses in the seven programs examined. The absence of quantifiable objectives and targets made it difficult to measure results against program objectives. In addition, the lack of a comprehensive risk assessment exposed some programs to risks that could have been better identified and treated in the early stages. The audit commented that substantial risks remained – particularly in terms of the timely achievement of program objectives. The need for a more consistent and transparent approach to assessing and selecting projects was also highlighted.

Audit objectives and scope[8]

Objective

7.12   The objective of this audit was to assess the effectiveness of the administration of specific climate change programs by the departments of the Environment, Water, Heritage and the Arts and Resources, Energy and Tourism. In undertaking this audit, particular emphasis was given to the implementation of good administrative practice and the extent to which the program objectives were being met. The audit followed four lines of inquiry:

- development of program objectives and assessment of program risks;

- assessment and approval of competitive grant applications;

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7   Department of the Environment, Water, Heritage and the Arts, Annual Report 2008-09.

8   The following information is taken from Audit Report No. 26 2009-10, pp. 15-16.

- assessment and approval of rebate applications; and

- measurement and reporting of program outcomes.

Audit scope

7.13   The audit scope included four programs managed by DEWHA. In March 2010, responsibility for these programs was transferred to DCCEE. These programs included two competitive grant programs and two rebate schemes. One competitive grant program was managed through DRET. The audit focused on the administration of the programs for the following periods:

- round three projects for GGAP (the first two rounds were considered in the 2003-04 audit);

- LETDF and Solar Cities from 2004-05 to 2009; and

- SHCP and RRPGP from 2007-08 (following the review and restructuring of the programs in 2007) to 2009.

Overall audit conclusions[9]

7.14   The ANAO made the following overall audit conclusion:

> The grant and rebate programs reviewed were designed to reduce GHG emissions and/or support the renewable energy industry. At a total value of $1.7 billion over the life of the programs, successive Australian Governments have invested significant resources in climate change initiatives. Funding under competitive grant programs has been for innovative and high risk projects such as large scale demonstration projects supporting new technologies to reduce greenhouse gas emissions. Grants ranged from $1 million to $100 million. In contrast, rebate schemes provided lower value, but a higher volume of assistance to support renewable technologies.
>
> Each program had different administrative issues and challenges and the effectiveness of some of these programs was constrained by weaknesses in program implementation and design. The overriding message for the effective management and success of future climate change programs is that greater consideration needs to be given to:

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9   The following information is taken from Audit Report No. 26 2009-10, pp. 16-18.

- setting clear and measureable objectives;

- assessing and implementing appropriate risk mitigation strategies;

- applying a rigorous merit based assessment of applications for competitive grants; and

- effective measuring and reporting on performance.

The objectives of the five climate change programs were generally broad, with three of the five programs, (Solar Cities, SHCP and RRPGP), having multiple objectives. These three programs had very little specificity in terms of how much was intended to be achieved over the life of the program, making it difficult to target resources and set administrative priorities.

The control and management of risks could have been substantially improved. The nature of the programs examined, involving large grants and new or unproven technology, meant that they were inherently high risk. However, where programs had undertaken risk assessments, the treatment options or controls did not always mitigate the risks identified, and many of these risks materialised throughout the course of the programs.

The assessment and selection of climate change projects under the LETDF and Solar Cities programs was transparent, with criteria used to assess all proposals. Generally, there was a high degree of rigour and technical expertise applied to the assessment process. However, the assessment and selection process for projects under GGAP was inadequate. Recommended (and subsequently approved) projects for the third funding round failed to meet the Government's guidelines and eligibility criteria, as no recommended project met the specified greenhouse gas abatement threshold. The rigour of the cost-benefit and technical analysis could have also been substantially improved and particularly the advice provided to the then Minister for the Environment.

Program achievements against objectives varied for the grant programs and rebate schemes. The high risk, large value grant programs have achieved minimal results to date. Actual achievements for GGAP, the longest running program, were substantially less than originally planned with only 30 per cent of planned emissions abatement being achieved. This underperformance was because of delays in finalising funding agreements and the termination of nine out of the twenty-three approved projects. LETDF and Solar Cities are not sufficiently advanced for any meaningful comments on overall program results to be made to date.

For the two rebate schemes, SHCP and RRPGP, demand outstripped available funds – particularly for SHCP. As a consequence, the SHCP has substantially contributed to growth in

the up-take of renewable energy in Australia. However, in terms of abatement, this has come at a high unit cost ($447/tonne/CO2e) and at a significant cost to the budget estimated to be $1.053 billion. The abatement achieved by the RRPGP program is also very expensive especially when compared to a possible emissions trading scheme market carbon price closer to $20-$30/tonne/CO2e.

Across the five programs examined, performance reporting could have been substantially better in terms of accuracy and consistency. If Parliament is to make informed judgements about what these, (and any future climate change programs) have achieved, reporting by agencies will need to more closely adhere to the annual reporting guidelines. In particular, reporting actual performance in relation to performance targets; and providing narrative discussion and analysis of performance.

To be effective, future programs will need to implement the key components of grant administration as outlined in the 2009 *Commonwealth Grant Guidelines*, particularly in terms of program planning and design and achieving value for public money. This audit has made one recommendation aimed at improving grant administration in DEWHA and could also be taken into account by DCCEE in terms of the ongoing administration of relevant programs. It has also identified a number of lessons that may have application to other grant programs in the departments concerned.

ANAO recommendation

Table 7.2   ANAO recommendation, Audit Report No. 26 2009-10

1.	In order to strengthen the consistency and core competencies in grant administration, the ANAO recommends that the Department of the Environment, Water, Heritage and the Arts and the Department of Climate Change and Energy Efficiency give priority to establishing a Grants Policy Unit to facilitate consistent practice across the department in terms of:
	(a) identifying and managing risk throughout the lifecycle of a program;
	(b) assessing and selecting projects that represent value-for-money and meet program objectives and criteria; and
	(c) monitoring project performance and reporting on whether program objectives are being achieved.
	DEWHA and DCCEE response:
	Agreed in principle, noting that the audited programs have transferred from DEWHA to DCCEE.

The Committee's review

7.15   The Committee held a public hearing on Wednesday 16 June 2010, with the following witnesses:

- Australian National Audit Office (ANAO);

- Department of Environment, Water, Heritage and the Arts (DEWHA); and

- Department of Climate Change and Energy Efficiency (DCCEE).

7.16   The Committee took evidence on the following issues:

- risk identification and management;

- assessment process;

- demand driven programs;

- performance reporting; and

- Grants Policy Unit.

Risk identification and management

7.17   The ANAO stressed that climate change programs are inherently high risk but noted that risk identification and management was often undertaken late in the implementation stage of the programs examined, preventing mitigation strategies being put in place early.[10] The Committee asked DCCEE what steps have been taken to tighten up risk identification and management of climate change programs.

7.18   DCCEE told the Committee that the Department has established a dedicated risk management team whose role it is to develop and implement a comprehensive risk management plan for each program:

> A key element of their work involves engaging with programs in the early stages of development to drive out a comprehensive risk assessment and risk management plan that will continue to evolve in line with the development, implementation and operation of the program. ... Key risks are reported on a regular basis to the Departmental Audit Committee and risk management information is held in an accessible format that allows managers and risk

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10   Audit Report No. 26 2009-10, pp. 46-50.

management specialists to monitor the implementation and on-going effectiveness of agreed risk mitigation treatments.[11]

Assessment process

7.19   With regard to the Greenhouse Gap Abatement Program (GGAP), the ANAO found that there were a number of cases where successful applications did not meet the program's eligibility criteria. In one instance a project had been previously rejected by a former Minister and three of the recommended projects were technically ineligible.[12] The Committee asked DCCEE if steps had been taken to tighten the assessment process to ensure successful applications meet the eligibility criteria for each program.

7.20   DCCEE indicated that the GGAP had closed and therefore no more applications were being considered for funding under that program.[13] With regard to future programs, the Department assured the Committee that a process of independent assessment of applications had been put in place:

> Subsequent competitive grant programs administered by the Department involving large complex grants, such as *Solar Cities* and the *Smart Grid, Smart City* initiative have utilised independent expert panels to oversee the assessment process and make funding recommendations.[14]

Demand driven programs

7.21   The ANAO noted that open-ended, demand driven programs run the risk of demand exceeding the budget. The ANAO suggested that 'an adequate range of controls' needs to be in place to deal with high levels of demand putting pressure on the budget.[15] The Committee asked DCCEE what type of controls could be put in place to better manage such a situation and mitigate the risk.

7.22   DCCEE assured the Committee that the Department has introduced a range of controls to address this issue. DCCEE emphasised the importance of tailoring controls to a particular program and to monitor effectiveness:

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11   DCCEE, submission no. 6, npn.
12   Audit Report No. 26 2009-10, p. 58.
13   DCCEE, submission no. 6, npn.
14   DCCEE, submission no. 6, npn.
15   Audit Report No. 26, 2009-10, p. 79.

> It is important that demand management strategies are considered early in the design of programs and that they are tailored to the particular target audience, objectives and parameters of each program. Regular tracking of demand is also critical to test the effectiveness of demand management controls and provide sufficient opportunity to adjust the controls if required.[16]

7.23 In its written submission to the inquiry, DCCEE provided examples of the controls put in place to manage the National Solar Schools Program (NSSP) including:

- Annual funding caps to be applied in each state and territory's government (state) and non-government sectors – the amount of each allocation will be consistent with each jurisdiction's share of the total national number of schools eligible for a NSSP grant that have not already received a grant.
- Schools now need to apply for funding during a five-week annual application round. This also assists to better manage the risk of uncontrolled demand placing pressure on the program's annual budget.
- Eligible schools' applications will be assessed against three criteria: value for money; environmental benefits; and educational benefits. A merit-based, competitive, assessment process will be used to determine which schools' applications best meet these criteria and should receive funding in each year. Any school not successful in one round is eligible to apply in subsequent years' application rounds. Over the life of the program, every eligible school has the potential to receive a NSSP grant; but schools with the most competitive applications will receive their funding earlier.
- The Solar Hot Water Rebate (SHWR) has been reduced twice in the last financial year (September 2009 and February 2010) as a strategy to successfully reduce demand and assist with managing the program within budget. In February 2010, the time to submit an application post installation was also reduced from six months to two months – giving a more timely view of Commonwealth liabilities. Demand is tracked on a weekly basis and forecasts adjusted to provide early warning of a potential overspend or significant underspend in a given financial year.[17]

Performance reporting

7.24 The ANAO was critical of performance reporting across the range of programs examined for this audit. The Committee is concerned that this

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16 DCCEE, submission no. 6, npn.
17 DCCEE, submission no. 6, npn.

issue has not been addressed despite being identified by the ANAO in previous audits of these types of programs.[18] The Committee asked DCCEE what steps have been taken to improve performance reporting for climate change programs.

7.25   DCCEE assured the Committee that significant steps have been taken to improve performance reporting for all of the programs examined in this report. Specifically the issues identified by the ANAO have been addressed by the following measures:

- The quality and timeliness of reporting for the Renewable Remote Power Generation Program has improved, with the database now functioning effectively. An end of program report is also currently being prepared which will provide a consolidated assessment of achievements.

- The SHWR, NSSP and SHCP programs provide weekly reports on volumes of applications received and paid which are consolidated into a report for the Department of the Prime Minister and Cabinet. This information is also provided to the responsible Minister's Offices.

- The SHCP program is scheduled to undertake a program evaluation during the current financial year, prior to all remaining rebates being paid. Monitoring and evaluation plans are also being established for the SHWR, NSSP, Green Loans Program and Green Start Program to provide information to assess achievements resulting from program expenditure.[19]

Grants Policy Unit

7.26   The ANAO recommended that DEWHA and DCCEE set up a Grants Policy Unit to facilitate improvement in the grants management process across both departments.[20] The Committee asked DEWHA and DCCEE if this Unit had been established and, if so, had it contributed to improvements in the grants management cycle to date.

7.27   DEWHA informed the Committee that the Unit has been established and incorporated into the Government Branch, Business Improvement Division.[21] The Department reported that improvements in the grants management cycle to date include:

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18   Audit Report No. 26 2009-10, pp. 93-96.
19   DCCEE, submission no. 6, npn.
20   Audit Report No. 26 2009-10, p. 28.
21   DEWHA, submission no. 8, npn.

> ... the establishment of the Grants Reference Group with
> representatives from Grant Programs across the Department.
> Progress has also been made on a grants Management Manual,
> standard templates and toolkits to provide guidance to line areas
> on grants management. A grants helpdesk has also been
> established to provide guidance across the Department on
> compliance with the Commonwealth Grant Guidelines
> requirements.[22]

7.28   DCCEE advised the Committee that the Grants Policy Unit was not
        transferred as part of the machinery of government changes and remains
        with DEWHA.[23] However, DCCEE has established a number of initiatives
        to improve grant administration.

> The Department's Legal Services Branch issues the Department's
> Grants Policy and is responsible for assisting with the drafting of
> funding agreements. The Department's Finance Branch co-
> ordinate the provision of new and amended grant guidelines.
> Assistance with broader frameworks for applying risk
> management and project management to grant schemes is
> provided by the newly established Governance and Program
> Support Division. This Division is actively working with program
> areas to improve planning, administration, resolution of legal
> issues, and implementation of compliance activities (from
> assurance through to fraud investigation).[24]

Conclusion

7.29   The Committee notes the likelihood that there will be an ongoing need for
        climate change programs to combat the potential effects of climate change
        on the Australian people and economy. The Committee is concerned that
        the programs implemented by successive governments have experienced
        a range of risk management and reporting problems and that relevant
        departments have not been able to successfully address these issues.

7.30   The Committee notes that DEWHA has implemented the ANAO
        recommendation to establish a Grants Policy Unit and that DCCEE has
        established concrete measures to address the issues identified by the

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22   DEWHA, submission no. 8, npn.
23   DCCEE, submission no. 6, npn.
24   DCCEE, submission no. 6, npn.

ANAO report. The Committee urges departments involved in administering these programs to continue to monitor and evaluate risk management and reporting procedures to ensure better value for money in future.

8

Audit Report No. 27 2009-10

Coordination and Reporting of Australia's Climate Change Measures

Introduction[1]

8.1   Climate change caused by the emission of greenhouse gases has been recognised as a global challenge. Although the impacts of climate change may vary worldwide, these can include increases in average surface temperatures, sea level rise, increased climate variability and extreme weather events, such as prolonged drought and severe storms.[2] There is evidence in Australia that climate change has already had an impact. The Australian Bureau of Meteorology has indicated that since the 1950s temperatures in Australia have, on average, risen by about one degree Celsius with an increase in the frequency of heatwaves and a decrease in the numbers of frosts and cold days.[3] Rainfall patterns have also changed with the northwest of Australia experiencing an increase in rainfall over the last 50 years, while at the time of the audit much of eastern Australia

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1   The following information has been taken from Audit Report No. 27 2009-10, *Coordination and Reporting of Australia's Climate Change Measures*, pp. 15-18.

2   M Parry, O Canziani and J Palutikof, World Meteorological Organisation Bulletin 57 (1) April 2008, *Key IPCC Conclusions on Climate Change Impacts and Adaptations*, p. 4.

3   Bureau of Meteorology, Monitoring Australia's Climate Change fact sheer, BOM available from <http://www.bom.gov.au/climate/docs/FactSheet3pdf> accessed 28 June 2010.

and the far southwest have experienced a decline in rainfall and prolonged drought conditions.

8.2   The United Nations Framework Convention on Climate Change (UNFCCC) was established in 1992. It sets out an overall framework for intergovernmental efforts to address the challenges posed by climate change. Australia is among some 194 national signatories to the convention, which is the primary forum for designing global climate change strategies. In recognition of the risks presented by rising greenhouse gas (GHG) emissions, the Kyoto Protocol was established under the convention in 1997. The protocol aims to foster national emission reductions through a binding international agreement. Forty countries, including Australia, have emission targets under the Kyoto protocol designed to be achieved over the five year Kyoto period, 2008-12.

8.3   The Government has indicated that addressing climate change is a high priority and more than $15 billion has been committed to climate change initiatives.[4] The Government's response to climate change is based on its *Three Pillars* strategy: reducing emissions; adapting to unavoidable climate change; and helping to shape a global solution.

8.4   The Department of Climate Change (DCC) was established in December 2007 to assist the government to pursue its climate change agenda. DCC had specific responsibility for:

- coordinating climate change policy;

- measuring and reporting national GHG emissions;

- international reporting commitments under the UNFCCC and the Kyoto Protocol; and

- measuring the impact of abatement measures towards national targets.

8.5   In March 2010, DCC became the Department of Climate Change and Energy Efficiency (DCCEE). The energy efficiency function of the Department of the Environment, Water, Heritage and the Arts was also transferred to the new department.

8.6   DCCEE also administers the recently legislated 20 per cent renewable energy target and has to implement the Carbon Pollution Reduction Scheme (CPRS) currently being proposed by the Government subject to the passage of the legislation by the Parliament.[5]

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4   Climate Change Budget Overview 2009-2010, p. 3.
5   The department has advised that it is establishing the Australian Climate Change Regulatory Authority to implement the CPRS.

8.7   State and Territory Governments have also introduced an extensive range of measures to reduce GHG emissions and to adapt to climate change. The Australian Government has been working with State and Territory Governments through the Council of Australian Governments (COAG) to achieve a coordinated intergovernmental response to climate change. In December 2007, COAG 'acknowledged the benefits in reducing the confusion, overlap, duplication, and red-tape associated with the current proliferation of climate change programs across jurisdictions.'[6] In March 2008, COAG agreed that each jurisdiction would review their climate change mitigation measures[7] in order to harmonise and align existing and future programs with the proposed emissions trading scheme.

8.8   To measure Australia's GHG contribution, the Australian Government has maintained a national emissions inventory since the early 1990s. The inventory, which is managed by DCCEE, provides a detailed national profile of Australia's emissions. The inventory is classified into six internationally defined sectors, based on particular emissions processes:

- energy (including stationary energy, transport and fugitive emissions);[8]

- industrial processes;

- solvents and other products;

- waste;

- agriculture; and

- land use, land use change and forestry (LULUCF).

8.9   Australia's largest emitting sector is stationary energy and, in 2007, it contributed to over half of the national GHG emissions.[9]

8.10   Data from the inventory is used to meet international reporting requirements under the UNFCCC and the Kyoto Protocol, and to track progress towards the Kyoto emissions target. Activity data, used to estimate GHG emissions, is principally sourced from other Australian

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6   Department of Finance and Deregulation, *'Strategic Review of Australian Government Climate Change Programs,'* Final Report, July 2008, p. 42.

7   Mitigation is achieved through abatement initiatives. The terms mitigation and abatement are used interchangeably throughout the report. Measures can include grant programs, regulation, incentives, rebate schemes and voluntary initiatives.

8   Fugitive emissions are by-products, waste or loss in the process of fuel production, storage or transport, such as methane released into the atmosphere during oil drilling and refining, or leakage from pipelines.

9   Department of Climate Change, *Australia's Fifth National Communication on Climate Change,* 2010, p. 5.

Government agencies, such as the Australian Bureau of Statistics. The introduction of the *National Greenhouse and Energy Reporting Act 2007* (NGER Act) has also meant new reporting arrangements, as the Act mandates annual emissions reporting for corporations whose energy production, energy use, or GHG emissions exceed defined thresholds. Data collected under the NGER Act will supplement existing data collection arrangements.

8.11   Measures to mitigate the production of GHG emissions have been undertaken by all jurisdictions, primarily through a mixture of regulatory measures, grant programs, incentive and rebate schemes. To assess the impact of Australia's climate change programs, reliable and accurate calculations of the amount of GHG emissions abated is necessary. Abatement estimates are calculated by DCCEE to determine the aggregate and likely future impact of Government measures. The Department's estimates are used to track Australia's progress towards meeting emissions targets, including the Kyoto Protocol target. Abatement estimates for individual programs are also calculated by the agency responsible for delivering the program. The impact of Australia's abatement initiatives are reported by DCCEE in public reports and in the four yearly National Communications report to the UNFCCC.

The Audit

Audit objectives[10]

8.12   The objective of this audit was to assess the coordination of Australian, State and Territory Government climate change programs and the integrity of measuring and reporting of Australia's greenhouse gas emissions and abatement. Particular emphasis was given to the:

- coordination of Australian Government and State/Territory climate change programs;

- integrity of the national inventory to measure Australia's greenhouse gas emissions; and

- integrity of measuring and reporting government abatement measures.

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10   The following information is taken from Audit Report No. 27 2009-10, p. 18.

Overall audit conclusion[11]

8.13   The ANAO made the following overall audit conclusion:

> Australian, State and Territory Governments are taking action in response to climate change. Measures have been put in place across all jurisdictions to reduce Australia's GHG emissions and, under COAG, programs are being streamlined. Since 1992, Australia has also been involved in international efforts to address climate change through the UNFCCC. Australia's national inventory has been improved over time and provides a sound basis for understanding the sources, trends and levels of emissions from industry sectors. The inventory is also used to measure and report on Australia's progress in meeting the Kyoto Protocol emission target of 108 per cent of 1990 levels (under the UNFCCC).

> In 2008, there were some 550 climate change related measures across jurisdictions, resulting in the overlap and duplication of programs. In general, the program reviews requested by COAG have resulted in some rationalisation and subsequent adjustment to programs to enhance complementarity and consistency with the proposed CPRS. However, progress in streamlining some State and Territory programs has been slower than anticipated by COAG, with some reviews yet to be finalised. There is still considerable scope for further rationalisation across jurisdictions. However, this is a matter for consideration by responsible governments.

> Australia's national GHG inventory is well developed and provides a reliable method for measuring and reporting national emissions. Technical reviews, overseen by UNFCCC accredited experts, indicate that the inventory broadly meets international requirements for data preparation and reporting. The department has implemented 74 per cent of UNFCCC recommendations but could improve its process for the ongoing management of outstanding recommendations by documenting required actions, resources and timeframes.

> The aggregate impact of all government mitigation actions has been revised by DCCEE over time. The estimated aggregate level of abatement is 74.5 Mt CO2e[12] annually over the five year Kyoto

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11   The following information is taken from Audit Report No. 27 2009-10, pp. 18-21.

12   Mt CO2e refers to millions of tonnes (Mt) of carbon dioxide equivalents (CO2e). 74.5 Mt CO2e represented 13.5 per cent of Australia's emissions in 2008 using Kyoto Protocol accounting.

Protocol period; a 15 per cent revision down from 2007. The downward revision reflects a more realistic assessment of program achievements as well as the termination and adjustments to a range of programs. The aggregate abatement is made up of 35 measures, covering programs, legislation and strategies. Of these measures, only nine account for 85 per cent of the aggregate abatement. A first step would be to more clearly define a 'measure' and focus on those measures that are quantifiable and materially significant in terms of overall national abatement.

Overall, the methodology employed by DCCEE to estimate the impact of abatement measures provides a reasonable level of assurance as to the integrity of the aggregate abatement. The department uses the best available program level data, takes into account reasonable assumptions of future uptake and gives consideration to the overlap between programs that can result in double counting abatement. Notwithstanding, improvements could be made in estimating individual abatement measures through a more comprehensive consideration of 'business as usual' operations,[13] the attribution of overlap to individual measures, and improvements in the quality and consistency of data provided by delivery agencies.

There is no consistent approach by delivery agencies to estimating abatement. Guidelines and methodology are currently being developed by DCCEE to assist agencies to calculate the impact of abatement measures and cost new climate change initiatives. To be effective, the methodology will need to be applied consistently across all relevant delivery agencies and be supported by administrative practices and performance reporting frameworks. Extending this approach in the future to State and Territory agencies would facilitate a nationally consistent approach to performance measuring and reporting on GHG abatement.

DCCEE publishes national *aggregate* abatement estimates in four-yearly international submissions to the UNFCCC. However, the 2010 submission did not provide comparable figures for individual measures as it only gave an estimate for 2020. The *Tracking to Kyoto* report also provided an *aggregate* abatement estimate for the Kyoto period. Although previous reports were supplemented by emission sector papers that provided details of *individual* measures, this did not occur for the 2009 report.

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13   Business as usual refers to the likely action taken in the absence of the measure.

Currently, the absence and variability of abatement figures being reported means that a consolidated picture of individual abatement measures and aggregate abatement is lacking. For greater transparency, abatement figures for individual measures and in aggregate could be reported more regularly by the department in a consolidated domestic publication.

The public reporting of achievements for individual measures has also not been consistent across Australian Government agencies and has generally been poor. Where abatement figures are published in annual reports, they are often not comparable across years or programs. A more consistent approach to reporting abatement programs would inform the Government and Parliament of the success, or otherwise, of government program achievements.

Despite these administrative shortcomings, current projections by DCCEE suggest that Australia is on track to meet its target under the Kyoto Protocol of limiting emissions to no more than 108 per cent of 1990 levels. Preliminary estimates by DCCEE indicate that Australia's total GHG emissions in 2008 were likely to limit emissions to 106 per cent of 1990 levels by 2012. However, confirmation of Australia's performance throughout the five year Kyoto period – through Australia's GHG inventory – will not be available until 2015.

ANAO recommendation

Table 8.1   ANAO recommendation, Audit Report No. 27 2009-10

1.	To increase transparency and consistency of reporting the impact of climate change abatement measures, the ANAO recommends that:
	(a) Australian Government agencies responsible for delivering climate change programs report abatement estimates/figures in annual reports and against program targets, where applicable; and
	(b) the Department of Climate Change and Energy Efficiency annually publish a consolidated report of all Government measures with estimates of current abatement and forecasts for five yearly intervals, and, where practicable, the net abatement of individual measures.
	DCCEE response: *Agreed*

The Committee's review

8.14   The Committee held a public hearing on Wednesday 16 June 2010, with the following witnesses:

■ Australian National Audit Office (ANAO); and

■ Department of Climate Change and Energy Efficiency.

8.15   The Committee took evidence on the following issues:

■ reviews;

■ National Framework for Australian Climate Change Science;

■ UNFCCC recommendations;

■ quality data collection;

■ abatement measurement guidelines;

■ 'business as usual factors'; and

■ reporting.

Reviews

8.16   The ANAO noted that the Council of Australian Governments (COAG) had established a Complementary Measures Sub-Group of Australian State and Territory governments to undertake a review of climate change mitigation measures being undertaken by State and Territory governments to streamline these measures across jurisdictions.[14] The reviews were due for completion by mid-2010. The Committee asked DCCEE if the reviews had been finalised.

8.17   DCCEE informed the Committee that the reviews had been completed and the final report is now available on the COAG website.[15]

National Framework for Australian Climate Change Science

8.18   The ANAO noted the importance of the National Framework for Australian Climate Change Science in avoiding costly overlaps and duplication in climate change research.[16] An implementation plan for the

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14   Audit Report No. 27 2009-10, pp. 49-52.

15   DCCEE, submission no. 6, npn. Report available http://www.coag.gov.au/reports/index.cfm.

16   Audit Report No. 27 2009-10, pp. 56-58.

Framework was expected to be completed by June 2010.[17] The Committee asked DCCEE for an update on the progress of the implementation plan.

8.19   DCCEE told the Committee that the Implementation Program for the Framework is being developed by the High Level Coordination Group, chaired by the Chief Scientist, and is expected to be completed by November 2010. The additional time has been necessary to ensure that:

> ... the Implementation Plan fully integrates the national climate change science effort, enabling resources to be deployed with maximum efficiency.[18]

UNFCCC recommendations

8.20   The ANAO noted that Australia's Greenhouse Gas Emissions Inventory is subject to an annual review by the United Nations Framework Convention on Climate Change (UNFCCC).[19] The Audit found that although 74 per cent of the UNFCCC recommendations for the latest review had been implemented there were 13 recommendations outstanding and that it was unclear 'how the department plans to handle these matters'.[20] The Committee asked DCCEE what steps the Department has taken to address these outstanding recommendations.

8.21   DCCEE explained that the UNFCCC reviews only become available late in the annual inventory cycle and recommendations cannot always be acted on in time to include in the imminent Inventory Report.[21] For example, in 2010 the UNFCCC review report was released on 5 March and the National Inventory Report was due on 27 May.[22]

8.22   DCCEE informed the Committee that after the release of the Audit Report, the Department has taken steps to ensure that progress on the implementation of recommendations is included in the National Inventory Report.[23] The Department told the Committee that the May 2010 National Inventory Report includes a list of the UNFCCC recommendations, a timeframe for implementation and actions taken to address each recommendation.[24]

17   Audit Report No. 27 2009-10, p. 58.
18   DCCEE, submission no. 6, npn.
19   Audit Report No. 27 2009-10, p. 65.
20   Audit Report No. 27 2009-10, p. 69.
21   DCCEE, submission no. 6, npn.
22   DCCEE, submission no. 6, npn.
23   DCCEE, submission no. 6, npn.
24   DCCEE, submission no. 6, npn.

8.23   In addition, DCCEE told the Committee that UNFCCC recommendations that will take time to implement have 'been included within the Department's work program for 2010-11' and progress on implementation will be included in the next National Inventory Report in April 2011.[25]

Quality data collection

8.24   The ANAO noted that the implementation of the *National Greenhouse Energy Reporting Act 2007* (NGER Act) would improve the quality of data collected for Australia's emissions inventory.[26] The Committee noted that the first data collected under this legislation had been due in late October 2009 for the 2008-09 financial year and asked DCCEE how the integration of this data into the inventory went.

8.25   DCCEE informed the Committee that the first data collected under the NGER Act is currently being integrated into Australia's National Inventory and will be included in Australia's next submission to UNFCCC in April 2011.[27]

8.26   The Committee inquired if the integration of the data had presented any difficulties for the Department. DCCEE told the Committee that the integration has required the 'development and refinement of the software used to manage the national inventory' and that this process has been managed over two inventory cycles and should be completed during 2011.[28]

8.27   The Committee asked DCCEE if the quality of the data collected had improved. The Department told the Committee that as a result of the data collected under the NGER Act the National Inventory will be more accurate.[29] DCCEE identified gaps in the data collection that will be filled and a number of areas where the collection process has been streamlined.[30] In its submission to the inquiry, the Department provided examples of the way the collected data will improve the overall outcome:

> The data collected will improve the quality of the emission estimates through a greater utilisation of facility-specific data, the increased use of higher-order tier 3 methods to estimate emissions and through improved allocation of data to individual sectors. The

25   DCCEE, submission no. 6, npn.
26   Audit Report No. 27 2009-10, p. 76.
27   DCCEE, submission no. 6, npn.
28   DCCEE, submission no. 6, npn.
29   DCCEE, submission no. 6, npn.
30   DCCEE, submission no. 6, npn.

reporting of standardised measurements made by individual facilities, encouraged under NGERs, will improve the accuracy of the inventory. Small improvements in the coverage of emission sources will also be achieved.[31]

Abatement measurement guidelines

8.28   The ANAO noted the need for a consistent and standardised approach to measurement of program abatement to enable governments to make informed decisions about the effectiveness of abatement programs.[32] The DCCEE advised the ANAO that a draft guidance document outlining such measures was being developed at the time of the Audit and was expected to be published by mid-2010.[33] The Committee asked DCCEE if that tool had been completed and implemented.

8.29   DCCEE informed the Committee that the proposed guidelines are still under development and that a draft is 'currently undergoing internal Departmental clearance processes'.[34]

'Business as usual' factors

8.30   The ANAO noted that in some cases it was difficult to distinguish between improvements in abatement caused by business as usual and economic initiatives and those resulting from government programs.[35] The ANAO suggested that more consideration should be given to the business as usual component within programs and broader abatement drivers in order to improve the integrity of individual estimates.[36] The Committee asked DCCEE if any steps had been taken to improve the consideration of business as usual factors and other economic drivers.

8.31   DCCEE informed the Committee that a program to improve individual estimates is underway and business as usual factors and other economic drivers would be considered as part of that work program.[37]

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31   DCCEE, submission no. 6, npn.
32   Audit Report No. 27 2009-10, p. 91.
33   Audit Report No. 27 2009-10, p. 91.
34   DCCEE, submission no. 6, npn.
35   Audit Report No. 27 2009-10, p. 85.
36   Audit Report No. 27 2009-10, p. 92.
37   DCCEE, submission no. 6, npn.

Reporting

8.32   The ANAO found that the level of reporting on the impact of individual
        programs across Government agencies was inconsistent and generally
        poor.[38] Further, the Audit found that the reporting on individual
        programs was often *ad hoc* making it difficult to consolidate and compare
        the results.[39] The ANAO recommended that responsible agencies report
        annually on abatement estimates/figures and that DCCEE publish an
        annual consolidated report.[40] The Committee asked the Department what
        steps have been taken to implement this recommendation and improve
        reporting.

8.33   DCCEE told the Committee that the Department has commenced a work
        program to improve the estimates of individual measures and that the
        updated abatement estimates was to be published in a consolidated report
        in 2010 to 'improve transparency and consistency'.[41]

Conclusion

8.34   The Committee is encouraged that Australia's Greenhouse Gas Emissions
        Inventory meets international requirements and acknowledges the steps
        being taken by DCCEE to improve the implementation of UNFCCC
        recommendations with regard to the Inventory.

8.35   The Committee acknowledges that further consideration will need to be
        given to ongoing rationalisation of Australian, State and Territory
        Government climate change programs to prevent overlap and duplication.

8.36   The Committee is concerned by the inconsistencies identified in the
        reporting of abatement measures across agencies and urges that
        Government agencies and the DCCEE fully implement the ANAO
        recommendation to improve this process. The Committee notes that the
        initiatives outlined in response to this audit report were still in progress of
        implementation at the time of this inquiry and therefore recommends that
        the DCCEE provide the Committee with a progress report on
        implementation within 12 months of the tabling of this report.

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38   Audit Report No. 27 2009-10, p. 97.
39   Audit Report No. 27 2009-10, p. 97.
40   Audit Report No. 27 2009-10, p. 98.
41   DCCEE, submission no. 6, npn.

Recommendation 4

The Committee recommends that the Department of Climate Change and Energy Efficiency provide the Committee with a progress report within 12 months of the tabling of this report on the concrete measures that have been implemented to improve the effectiveness of Australian government abatement programs.

The report should include:

- **a copy of the finalised abatement measurement guidelines;**

- **examples of how 'business as usual' factors and other economic drivers have been taken into account when measuring individual estimates; and**

- **a copy of the annual report showing the consolidated abatement figures across responsible agencies.**

9

Audit Report No. 31 2009-10

Management of the AusLink Roads to Recovery Program

Introduction[1]

9.1   Of the nation's 810,000 kilometres of public roads, more than 650,000 kilometres (80 per cent) are local roads within the responsibility of local government.[2] Approximately one-third of these roads are sealed, with the remainder being unsealed (unformed, formed or gravel roads).[3]

9.2   The AusLink Roads to Recovery Program is an administered program within Outcome 1 ('Assisting the Government to provide, evaluate, plan and invest in infrastructure') of the Department of Infrastructure, Transport, Regional Development and Local Government (DITRDLG). Roads to Recovery is the largest investment in local roads ever undertaken. In total, over 13 years, $4.18 billion[4] is to be paid by the

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1   The following information is taken from Audit Report No. 31 2009-10, *Management of the AusLink Roads to Recovery Program*, pp. 13-15.

2   AusLink Annual Report 2007-08, p. 23.

3   DITRDLG, *Local Government National Report: 2006-07 Report on the Operation of the Local Government (Financial Assistance) Act 1995*, p. 7. At the time of the ANAO audit the 2007-08 Report had not been presented to the Parliament.

4   For the composition of the $4.18 billion see Figure 1.1 in Chapter 1 of Audit Report No. 31 2009-10.

Australian Government to local government for expenditure on the construction and maintenance of roads.

9.3   There have been four Roads to Recovery (R2R) Programs. The initial Program was established by the *Roads to Recovery Act 2000* (R2R Act) and provided $1.2 billion over four years. It commenced in early 2001 as a single intervention to address the concern that local government road infrastructure was near the end of its economic life and its replacement was beyond the capacity of local government. The initial program was the subject of an Australian National Audit Office (ANAO) performance audit tabled in March 2006.[5]

9.4   A second four-year program commenced in July 2005, as part of the AusLink Land Transport Initiative. The AusLink R2R Standard program was established under the *AusLink (National Land Transport) Act 2005* (AusLink Act or the Act)[6] and provided $1.23 billion. There was also a separate, but related, AusLink R2R Supplementary Program concurrently in operation from June 2006 to June 2009 that provided $307.5 million (the third program).

9.5   A fourth program commenced under the Nation Building banner[7] on 1 July 2009 and will continue through to 30 June 2014. The Nation Building R2R Program will provide $1.75 billion.

9.6   It is the second and third R2R Programs (the AusLink R2R Programs) that are the subject of this performance audit.

AusLink R2R Programs

9.7   Under the AusLink R2R programs, a total of $1.537 billion was paid to more than 720 Local Government Authorities (LGAs) between July 2005 and June 2009. The distribution of R2R funds between the States and Territories was determined at the Ministerial level. In arriving at the actual distribution, consideration was given to the historical results from using the Financial Assistance Grants (FAGs) identified for local roads; and population and length of road under the control of the local government, with each of these two statistics weighted equally.[8] In turn, the allocation

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5   ANAO Audit Report No. 31 2005-08, *Roads to Recovery*, Canberra, 1 March 2006.

6   In June 2009, the *Nation Building Program (National Land Transport) Act 2009* (Nation Building Act) replaced the AusLink Act as the relevant land transport legislation.

7   Programs previously administered under the name 'AusLink' were renamed as *Nation Building* programs in 2008-09. (DITRDLG Annual Report 2008-09, p. 22).

8   Consideration was also given to the long standing concern of South Australia that it received a disproportionately low level of funding under the FAGs identified for local roads.

of funds within each State was determined using the formula applied by State Grants Commissions for FAGs identified for local roads.

9.8   Under the Standard Program, each Local Government Authority (LGA) was guaranteed its full life of program allocation by 30 June 2009, subject to the submission of satisfactory documentation such as work schedules and Quarterly and Annual Reports. Almost all LGAs received their full R2R allocation. Larger LGAs generally received an annual allocation capped at one quarter of their life of program allocation. However, subject to meeting certain conditions, smaller LGAs could access their full allocation at the start of the program. LGAs were required to spend all of their Standard Program funds by 31 December 2009.

9.9   The May 2006 Budget announced that a further $307.5 million would be provided in 2005-06 as a supplement to the AusLink R2R Standard Program. Under the Supplementary Program, each funding recipient received a grant equal to one quarter of its life of program allocation under the Standard Program. The funds were distributed and administered under similar funding conditions to those of the Standard Program, with funding recipients being required to acquit their project expenditures by submitting Quarterly and Annual Reports. However, unlike the Standard Program, funding recipients received their Supplementary Program allocations as a one off payment in June 2006, and were required to expend these funds by 30 June 2009.

9.10   The focus of the R2R Program is the renewal of local roads to meet social and economic needs. Most of the funds are provided in the form of grants direct to LGAs. These grants, together with other aspects of the program, are administered by a manager and up to three staff in the South East Roads Branch within the Canberra offices of DITRDLG. The small number of staff reflects the following program delivery decisions made at the time the program was first introduced:

   ■ funds were to be paid directly to LGAs;

   ■ project priorities were the choice of LGAs; and

   ■ the process by which grants were paid to the LGAs was to be simple, with appropriate audit and accountability systems and arrangements put in place to ensure that there is due recognition by LGAs of the Commonwealth's contribution to local road projects.

The Audit

Audit scope and objectives[9]

9.11   The audit scope covered the management of the AusLink R2R Standard Program and the AusLink R2R Supplementary Program. The scope did not include management of the Nation Building Roads to Recovery Program, which has only recently commenced. The audit objectives were to:

- assess the effectiveness of the management of the AusLink Roads to Recovery program;

- assess the delivery of the program and management of the funding, including the extent to which the program has provided additional (rather than substitute) funding for land transport infrastructure; and

- identify opportunities for improvements to the management of the program.

9.12   A key part of the audit involved examination of the use of, and accountability for, R2R funds by a representative sample of 41 LGAs from four States/Territories (representing almost six per cent of all funding recipients and eleven per cent of total funding provided under the program). This work included site inspections of more than 560 R2R funded projects, analysis of financial and other reports provided by the 41 LGAs to DITRDLG, and substantiation of the amounts charged to the program for selected projects. To supplement the audit sample, ANAO analysed data in the Department's Infrastructure Management System (IMS).

Overall audit conclusions[10]

9.13   The ANAO made the following overall audit conclusions:

> The R2R Program encompasses the largest investment in local roads undertaken by the Australian Government. By the time the Nation Building R2R Program concludes in June 2014, some $4.18 billion will have been paid over 13 years to local government for expenditure on the construction and maintenance of roads.

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9   The following information is taken from Audit Report No. 31 2009-10, pp. 15-16.
10   The following information is taken from Audit Report No. 31 2009-10, pp. 16-18.

As part of the AusLink R2R Standard and Supplementary Programs audited by ANAO, more than $1.5 billion was paid to local government for expenditure on the construction and maintenance of roads in respect of more than sixteen and a half thousand projects. Almost all LGAs received their full R2R allocation under the Standard Program and all LGAs received their Supplementary Program allocations as an up front, once only payment. Accordingly, the key aspect of the programs relating to distribution of funds to local government and LGAs using these funds for road works have been effectively administered.

In terms of the benefits from the R2R Program, a fundamental principle underpinning the program is that the funding provided to LGAs was to be additional to existing road funding. Accordingly, LGAs are required to maintain their own spending on local roads and report their performance in this regard to the department. Over time, the expenditure maintenance obligation placed on LGAs has been made less demanding but still, there have been significant numbers of LGAs that have not maintained their own expenditure in one or more years (and some LGAs have not maintained their own expenditure in any year). In these circumstances, the administrative practice adopted has been to waive the requirement where a satisfactory explanation has been provided and ask that the shortfall be made up in later years; but this often does not occur.

Another key aspect of program design was to pay LGAs quarterly in advance based on LGAs reporting the expenditure to date and forecast expenditure for the next three months in respect to each project they were undertaking under the program. Paying up to three months in advance was seen as necessary so that LGAs did not have to transfer funds from roadworks funded from their own resources.[11] However:

- there have been many instances of LGAs being paid more than three months in advance due to factors such as accelerated funding during the last quarter of each financial year (so as to fully spend the annual program allocation) notwithstanding that these payments did not reflect LGA cash flow needs, and LGAs overstating their actual expenditure and/or submitting unreliable expenditure forecasts;

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11   In practice, DITRDLG scheduled the payments to LGAs for around the middle of the relevant quarter.

- experience with the program has shown that many LGAs do not require payments to be made in advance, such that 54 per cent of all payments made under the Standard Program have been made in arrears (and 90 per cent of LGAs were paid in arrears in one or more quarters); and
- the cost to the Commonwealth of advance payments remains considerable (up to $16.3 million over the life of the AusLink R2R Standard Program).[12]

Reflecting the judgement that LGAs were best placed to make decisions on road investment at the local level, the grant payment and acquittal processes were designed to be simple. However, there have been a range of important funding conditions where LGA compliance has been less than satisfactory. In this respect, and without detracting from the responsibility of individual LGAs to adhere to the prescribed funding conditions, there would be benefit in the department adopting a range of cost-effective strategies aimed at improving understanding of, and adherence to, program funding conditions and administrative arrangements by LGAs and their auditors. ANAO has made one recommendation to this end.

In addition, in light of experience as to how the program has operated over its first ten years, there would be benefit in the department reviewing key elements of the program design so as to confirm their continuing appropriateness, or otherwise proposing variations (recognising that decisions on program design are a matter for Government). In particular, there is value in consideration being given to:

- the formula that has been used to allocate R2R funding to individual LGAs in light of evidence of capacity constraints that affect the ability of some LGAs to both spend their R2R funds as well as maintain their own source expenditure on roads; and
- paying LGAs in advance rather than in arrears given that many LGAs have not sought payments to be made in advance and a significant proportion of advance payments that have been made have remained unspent by the respective LGAs for considerable periods of time.

DITRDLG has substantially implemented all recommendations made during the previous audit aimed at improving the administration of the program. In light of further experience with the program, ANAO has made a further two recommendations directed towards enhancing the administration of program accountability arrangements and strengthening the program governance framework.

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12 ANAO's audit of the initial R2R estimated the interest cost of payments in advance to be between $8.4 million and $19.4 million (ANAO Audit Report No. 31 2005-06, p. 29).

ANAO recommendations

Table 9.1   ANAO recommendations, Audit Report No. 31 2009-10

1.	ANAO *recommends* that the Department of Infrastructure, Transport, Regional Development and Local Government strengthen the governance framework for the Roads to Recovery program, including by:
	a) better resourcing the existing program of contracted financial audits of Local Government Authorities so that the program of audits is able to be fully delivered; and
	b) giving greater emphasis to structured risk management and program evaluation.
	DITRDLG Response: Agree.
2.	ANAO *recommends* that, in light of the experience to date with the program, the Department of Infrastructure, Transport, Regional Development and Local Government review and advise Ministers on program design arrangements that will promote timely local government expenditure of Roads to Recovery funding on road work that is additional to that which would have otherwise occurred.
	DITRDLG Response: Agree.
3.	ANAO *recommends* that the Department of Infrastructure, Transport, Regional Development and Local Government improve accountability to the Parliament for the Roads to Recovery Program by setting and reporting in its departmental Annual Report against an effectiveness target for the program.
	DITRDLG Response: Agree.
4.	ANAO *recommends* that, given the importance to both the Roads to Recovery and Strategic Regional Programs of Local Government Authorities maintaining their own level of expenditure on roads, the Department of Infrastructure, Transport, Regional Development and Local Government:
	a) obtain greater assurance over the accuracy of own source roads expenditure reported to it by Local Government Authorities by requiring these figures to be included in the scope of the Audit Certificate included with each Authorities' Annual Report on the use of program funds; and
	b) develop a more effective range of sanctions to apply in circumstances where own source expenditure has not been maintained, with a particular focus on those Local Government Authorities that frequently fail to maintain their annual expenditure and/or that do not make up shortfalls in later years.
	DITRDLG Response: Agree.

The Committee's review

9.14   The Committee held a public hearing on Monday 21 June 2010, with the following witnesses:

- Australian National Audit Office (ANAO); and

- Department of Infrastructure, Transport, Regional Development and Local Government (DITRDLG).

9.15   The Committee took evidence on the following issues:

- expenditure maintenance requirements;

- data quality;

- reporting;

- strategic planning; and

- specificity of recommendations.

Expenditure maintenance requirements

9.16   The ANAO noted that, to deter cost shifting from Local Government Authorities (LGAs) to the Commonwealth under the R2R program, LGAs were expected to maintain the level of their own source expenditure on maintenance and construction of local roads.[13] However, the ANAO noted that DITRDLG has adopted an administrative practice of waiving this expenditure requirement 'where a satisfactory explanation has been provided and [asking] that the shortfall be made up in later years.'[14]

9.17   The Committee noted that DITRDLG has never refused such a request from a LGA and asked DITRDLG to provide reasons for these decisions. The Department explained that the decision is determined on the information supplied by the LGA for the request and admitted that the process could be tightened:

> ... if the work has not proceeded for a particular reason and it is reasonable or if the council has not expended its money in the six months after receiving it and there is a good enough reason, then the department will be inclined to provide a waiver. It is true that no waiver was refused during the life of the programs that this audit was looking at, but ... we are seriously looking at how those sanctions might be better applied to deal with expenditure maintenance.[15]

9.18   The Committee observed that there had been a distinct improvement in some of the breaches and waivers of expenditure maintenance requirements from 2005-06 to 2008-09. The Committee noted the halving

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13   Audit Report No. 31 2009-10, pp. 22, 129-131.

14   Audit Report No. 31 2009-10, p. 16.

15   Mr Foulds, DITRGLG, p. 4.

of the total deficiency and asked DITRDLG how the improvements had been achieved. The Department told the Committee that implementation of the recommendations from a previous ANAO report had contributed to the improvement.[16] DITRDLG also cited improved communications between the Department's team and LGAs and indicated that LGAs have gained familiarity with the processes and requirements of the program.[17]

Data quality

9.19   The ANAO found that the reporting of own source expenditure by LGAs has been prone to error for a number of reasons, calling into question the accuracy of DITRDLG figures regarding compliance with expenditure maintenance requirements.[18] The Committee asked the ANAO and the Department to clarify its concerns regarding the accuracy of the figures.

9.20   The ANAO identified the self-reporting nature of the process as a major concern:

> ... to date those figures only report those councils which are actually acknowledging to the department that they have not met their obligations. ... In general people do not say they have not met something when they have; the error goes the other way.[19]

9.21   DITRDLG identified another concern as the reference amount used by LGAs to determine their own source expenditure requirement.[20] The reference amount is a 'moving average' and changes over time as the LGAs' road expenditure changes.[21] The Department explained that the changes in the reference amount of individual councils distorts the aggregated data:

> So in some councils they can be considered to be meeting their expenditure maintenance obligation today by spending much less than they were spending in the first year of the program. What we are saying is that just the percentage of councils that meet the requirement does not tell the full story because the requirement has got easier over time, but also the way that councils can report

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16   Mr Foulds, DITRDLG, p. 4.
17   Mr Foulds, DITRDLG, p. 4.
18   Audit Report No. 31 2009-10, pp. 136-40.
19   Mr Boyd, ANAO, p. 5.
20   Mr Farmer, DITRDLG, p. 5.
21   Mr Farmer, DITRDLG, p. 5.

against that has got easier as well, so that does not give you the full picture.[22]

9.22   The Committee asked what DITRDLG has done to improve the accuracy of the data collected on own source expenditure. The Department told the Committee that it has taken steps to more precisely define the reporting requirements for the current R2R program.[23] DITRDLG has also adjusted the formula used to calculate its own source revenue figure. The figure was previously calculated by averaging the previous four years own source expenditure or taking the highest and lowest figure.[24] The Department now provides LGAs with a third option which includes an escalation factor to accommodate those councils experiencing a loss of revenue:

> If a council's own source revenue declines, the ready reference amount can be adjusted downwards accordingly. The Department's view is that it would be unfair to require a council to maintain its own source expenditure on roads at a fixed level if its own source revenue is declining.[25]

9.23   The Committee expressed some concern that allowing LGAs to choose the method of calculating the reference amount could open the system to abuse. DITRDGL reminded the Committee that the aim of the program was to facilitate road works in regional areas by providing funding to LGAs through a simple process that was not onerous for councils to administer.[26] The Department assured the Committee that appropriate checks are in place:

> It does provide flexibility, and the department does actually check off on the choice made by a council. It is not arbitrary. We agree that that is the approach that a council will take.[27]

Reporting

9.24   The ANAO noted that in 2008-09 the Portfolio Budget Statement (PBS) required DITRDLG to report against the key performance indicator of 'efficient and effective management' of the R2R Program.[28] The target was

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22   Mr Farmer, DITRDLG, pp. 5-6.
23   Mr Foulds, DITRDLG, p. 6.
24   Mr Foulds, DITRDLG, p. 6.
25   Mr Foulds, DITRDLG, p. 6.
26   Mr Foulds, DITRDLG, p. 7.
27   Mr Foulds, DITRDLG, p. 7.
28   Audit Report No. 31 2009-10, p. 108.

that the program be 'administered in accordance with relevant legislation, published guidelines and ANAO guidance'.[29] The ANAO found that DITRDLG's 2008-09 Annual Report did not mention this indicator.[30]

9.25   The Committee asked DITRDLG why this information had not been included in the 2008-09 Annual Report and whether or not it would be included in the 2009-10 Annual Report. The Department was unsure why it had not been included in the 2008-09 Report and assured the Committee the information will be included in the 2009-10 Report.[31]

9.26   The Committee notes with some concern that the indicator is included in the 2009-10 Report but that there is no clear indication of how the indicator was measured. The Committee also notes that although it has been reconfigured, the information included in the 2009-10 Report is similar to the information included in previous reports and does not address the concerns raised by the ANAO.

9.27   Overall, the ANAO found that the Annual Program Reports to Parliament were neither timely nor effective and recommended that the Department improve accountability to the Parliament by 'setting and reporting in its departmental Annual Report against an effectiveness target for the program.'[32] The Committee asked DITRDLG what steps have been taken to implement this recommendation and improve the standard of reports to Parliament.

9.28   DITRDLG advised the Committee that it is undertaking a review of the administrative arrangements and, in the course of that review, will develop an effectiveness target for the program. The Department added that the review will be completed by April 2011 and the results will be included in the Annual Report for 2010-11.[33]

Strategic planning

9.29   Committee Members cited anecdotal evidence indicating that there is a flurry of road maintenance work in communities just before the end of the financial year suggesting that LGAs are not taking a strategic approach to the delivery of road works. The Committee asked DITRDLG if there was evidence of a planned approach by LGAs. The Department pointed out that local roads are of immediate concern to LGA constituents and that the

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29   Audit Report No. 31 2009-10, p. 108.
30   Audit Report No. 31 2009-10, p. 109.
31   Mr Farmer, DITRDLG, p. 10.
32   Audit Report No. 31 2009-10, pp. 110-12.
33   Mr Foulds, DITRDLG, p. 3; Mr Farmer, DITRDLG, p. 11.

evidence indicates that LGAs are concerned to use their funding effectively:

> The councils have a very strong vested interest in the quality of the road network in their council area. I would say that they have a very strong interest in spending the money wisely.[34]

Specificity of recommendations

9.30   The Committee raised a general concern with the ANAO regarding the specificity of its recommendations. Members of the Committee voiced the opinion that more detailed recommendations would provide better guidance for departments.

9.31   The Auditor General replied that the ANAO has found it more effective to deliberately focus on a number of key issues arising from each audit.[35] The Auditor General told the Committee that the ANAO has also become 'outcomes orientated in our recommendations rather than articulating a particular process'.[36] Using the example of the R2R Program, he demonstrated to the Committee that the development and implementation of new policy and procedures requires lengthy consultation with all stakeholders to ensure an effective result.[37] This needs to be undertaken by the department concerned if workable solutions to the issues identified by an audit are to be put in place.[38]

Conclusion

9.32   The Committee acknowledges that there has been a distinct improvement in the noncompliance figures with regard to expenditure maintenance requirements for the R2R Program. However the inconsistencies identified by the audit in the quality of data used to measure the efficiency and effectiveness of the program are of concern to the Committee.

9.33   The Committee notes that DITRDLG has agreed to implement all of the ANAO recommendations and notes the Department's assurance that future Annual Reports will provide the Parliament with a more accurate

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34   Mr Farmer, DITRDLG, p. 12.
35   Mr McPhee, ANAO, p. 8.
36   Mr McPhee, ANAO, p. 8.
37   Mr McPhee, ANAO, p. 8.
38   Mr McPhee, ANAO, p. 8.

assessment of the Program. The Committee will keep this matter under review.

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Audit Report No. 33 2009-10

Building the Education Revolution – Primary Schools for the 21st Century

Introduction[1]

10.1   The onset of the global financial crisis in 2008 caused a severe loss of confidence, not only in the financial sector, but also in households and businesses around the world. The crisis has been attributed to a range of factors including: the sudden end of the United States housing boom; novel debt financing arrangements; and weaknesses in regulatory oversight. The result was a period of worldwide economic downturn and a prospect of rising unemployment in many countries.

10.2   In response, many governments around the world have adopted fiscal measures to support employment and economic recovery. There has also been coordinated international action through the Group of Twenty (G-20) countries, of which Australia is a member, to provide liquidity, address regulatory deficiencies, unfreeze credit markets and ensure that international financial institutions are able to provide support for the global economy.

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1   The following information is taken from Audit Report No. 33 2009-10, *Building the Education Revolution – Primary Schools for the 21st Century*, pp. 11-13.

10.3   Domestically, the Australian Government announced a series of stimulus measures in late 2008 and early 2009. The largest was the $42.1 billion Nation Building and Jobs Plan, announced on 3 February 2009. To oversee the implementation of the Plan, the Government established a network of jurisdictional and sectoral coordinators headed by a Coordinator-General within the Department of the Prime Minister and Cabinet.[2]

10.4   The largest component of the Nation Building and Jobs Plan is the delivery of school infrastructure under the Building the Education Revolution (BER) program. The Government decided on school-based infrastructure spending because it has a number of elements that supported stimulus objectives, including:

- it has the advantage of providing stimulus to almost every population area of the country, as the economic slowdown was expected to be geographically widespread;

- school land is available immediately without the need for planning approval, hence no planning delays were envisaged; and

- school infrastructure projects have low import content, which raises the domestic stimulatory impact.[3]

10.5   The objectives of the BER program are first, to provide economic stimulus through the rapid construction and refurbishment of school infrastructure and, second, to build learning environments to help children, families and communities participate in activities that will support achievement, develop learning potential and bring communities together.[4]

10.6   The program comprises three elements:

- Primary Schools for the 21st Century (P21), which initially provided $12.4 billion (later, $14.1 billion) for Australian primary schools to build new facilities, such as libraries and multipurpose halls, or to upgrade existing facilities, by 31 March 2011[5];

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2   The Coordinator-General is responsible for working with administering agencies at the Australian Government and State-Territory level to support and monitor the implementation of key infrastructure and stimulus measures.

3   Gruen, D., 8 December 2009, *The Return of Fiscal Policy*, speech to the Australian Business Economists Annual Forecasting Conference, Canberra, p. 4.

4   Council of Australian Governments, 2009, *National Partnership Agreement on the Nation Building and Jobs Plan*, Canberra.

5   In October 2009, the Government agreed to rephrase $500 million of BER program funding from 2010-11 to 2011-12, with the Minister for Education, Employment and Workplace Relations provided with flexibility to allow construction completion deadlines to be varied

- National School Pride, which provided $1.3 billion for minor capital works and refurbishment projects in all eligible Australian schools, to be completed by February 2010; and

- Science and Language Centres, which initially provided $1 billion (later, $821.8 million) for construction of new, or refurbishment of existing, science laboratories or language learning centres in secondary schools by 30 June 2010.

10.7   The Department of Education, Employment and Workplace Relations (DEEWR) was given responsibility for implementing the program, working through state and territory education departments and Block Grant Authorities (collectively referred to as 'Education Authorities') to facilitate the achievement of program outputs and outcomes.[6] These Education Authorities are responsible for implementing the program in government and non-government schools respectively, including responsibility for ensuring that individual projects achieve value-for-money.

10.8   The BER program is being delivered under the new federal financial relations framework through the *National Partnership Agreement (NPA) on the Nation Building and Jobs Plan: Building Prosperity and Supporting Jobs Now*.[7] The NPA sets out high level governance arrangements for delivery of the BER program in partnership with the states and territories including: outputs and outcomes; roles and responsibilities; and performance benchmarks. The devolved delivery of the program by Education Authorities has been governed by the establishment of bilateral agreements and funding agreements with non-government Education Authorities. These documents were drafted by DEEWR and are supported by BER Program Guidelines, with implementation plans submitted by Education Authorities to outline their delivery approaches.

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where this would assist with the achievement of value-for-money outcomes. The rephrasing means that some BER P21 projects will be completed after 31 March 2011.

6   Block Grant Authorities (BGAs) are bodies that represent non-government schools in the states and territories for capital funding purposes. There are 14 BGAs, one for each of the two territories that represents both the Catholic and Independent sectors, and two in each state (one for Independent schools and another for Catholic schools).

7   The new framework for federal financial relations, which commenced on 1 January 2009, aims to provide clearer specification of the roles and responsibilities of each level of government so that the appropriate government is accountable to the community. It also aims to provide more transparent reporting of outputs and outcomes to drive better service delivery and reform.

The Audit

Audit objective[8]

10.9   The audit objective was to examine the effectiveness of the department's establishment of the P21 element of the BER program. The focus of the audit was on: the establishment of administrative arrangements for BER P21 in accordance with government policy; the assessment and approval of funding allocations; and the arrangements to monitor and report BER P21 progress and achievement of broader program outcomes. An examination of individual BER P21 projects was outside the scope of the audit.

10.10   The Committee notes that the jurisdictional issues brought into focus by the BER audit have been examined in more detail in the Committee's review of the *Auditor-General Act 1997*. A report on this inquiry is being finalised as at November 2010.

Overall audit conclusion

10.11   The ANAO made the following overall audit conclusion:

> The Building the Education Revolution (BER) program formed a major part of the Australian Government's response to the global financial crisis. At $12.4 billion (later, $14.1 billion), the P21 element of the BER program represented a doubling of recent levels of capital investment in schools and the single largest component of the Government's economic stimulus package.

> BER P21 is a large, high profile program that required rapid establishment to maximise its stimulatory effect. ... The focus on quick implementation needed to be balanced with the objective of delivering quality, sustainable and value-for-money primary school infrastructure.

> ... The task facing DEEWR and Education Authorities was considerable, with infrastructure projects to be delivered in almost every school across the country within very compressed timeframes – as little as a third of the time usually set aside for school infrastructure projects. The program was also established within a new framework for intergovernmental program delivery that was untested for a program of this kind, and a coordination

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8   The following information is taken from Audit Report No. 33 2009-10, p. 13.

structure that added to the monitoring and reporting obligations on administering agencies.[9]

10.12   The ANAO found that there are some early indicators that the program is achieving its intended outcomes:

> Lead economic indicators, including construction approvals, show that the introduction of BER P21 contributed to a reversal in the decline in non-residential construction activity that resulted from the global financial crisis. Education industry stakeholders, including peak bodies, Education Authorities and a substantial majority of school principals have also been positive about the improvement in primary school facilities that will result from the program.

10.13   The ANAO noted that DEEWR had put in place governance and delivery arrangements to ensure the challenging timeframe was met:

> The department established a BER Taskforce to develop governance and delivery arrangements. This work comprised: drafting the BER Guidelines (publicly released in late February 2009) and negotiating bilateral/funding agreements with all Education Authorities (executed by mid-April 2009). Within six months from the program's announcement, DEEWR completed three funding rounds, approving 10,700 BER P21 projects in around 8,000 schools. This represented a substantial body of work undertaken in a compressed timeframe.[10]

10.14   The ANAO found that the BER Guidelines ensured that around 78 per cent of BER P21 projects commenced on time.[11] However, construction of the projects has progressed more slowly than intended to provide the full benefit of the stimulus. Completion milestones were adjusted depending on the size of the school and the ANAO found that 34 per cent of Round 1 projects and 9.6 per cent of Round 2 projects had been completed at the time of the audit.[12]

10.15   The ANAO noted that both the Strategic Priorities and Budget Committee of Cabinet (SPBC) and DEEWR were aware that the funding allocated to the BER P21 program would be inadequate to meet the demand:

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9   Audit Report No. 33 2009-10, p. 14.

10   Audit Report No. 33 2009-10, p. 15.

11   Project commencement was defined as: *the undertaking of any action, post any design phase that incurs an expense covered by BER funding for that project.* DEEWR has further advised that, as at 28 February 2010, 97 per cent of BER P21 projects have commenced.

12   Audit Report No. 33 2009-10, pp. 15-16.

In establishing the program, the Government decided on funding maxima per school depending on school size, and allocated $12.4 billion to BER P21. However, within six months of announcing BER P21, the Government found it necessary to allocate a further $1.7 billion to the program. Essentially, the original BER P21 budget was based on an underlying assumption that BER P21 as a whole would be completed for 90 per cent of the cost of providing the maximum funding for each school. In establishing the program, the approach adopted made maximum per school funding available to all schools. As was evident to DEEWR at the outset, this approach would require greater overall funding than had been formally approved by government. In the normal course of events, particularly when the increase in funding is likely to be substantial, administering agencies would be expected to return promptly to government to outline the case for additional funding and seek formal approval. However, in the case of BER P21, Ministers comprising the Strategic Priorities and Budget Committee of Cabinet (SPBC) advised that they understood schools would be able to undertake a project or a number of projects to fully utilise the amount of funds allocated to the school based on school size; they were aware from the outset that the BER P21 funding envelope represented only 90 per cent of possible expenditure; and it was therefore evident and transparent to SPBC ministers that, depending on the response of schools, a budget estimates variation may be required.[13]

10.16   The ANAO acknowledged the economic imperative to implement the program expeditiously, but was critical of the constraints placed on Education Authorities by DEEWR. The ANAO found that the administrative rules and requirements put in place by DEEWR also went against the current reforms for the delivery of intergovernmental programs:

The establishment of the BER program, in the context of the financial crisis and need for a prompt government response, meant that implementation issues were more likely to arise due to the limited time available for policy development and program planning. This was acknowledged by the Government at the time delivery arrangements were announced. It was, therefore, important for DEEWR to develop effective arrangements for

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13   Audit Report No. 33 2009-10, p. 16.

collaboration both with other Commonwealth agencies and with the Education Authorities responsible for delivering the program.

Nevertheless, administrative decisions taken by the department in establishing BER P21, while designed to drive delivery of the program by Education Authorities, have unduly constrained the flexibility of authorities to determine how the program will be delivered within their jurisdictions to achieve the intended objectives and increased the administrative effort necessary to deliver the program.[14]

The adoption of this approach for states and territories expanded DEEWR's role in service delivery and, as such, was not in step with the thrust of recent reforms to the delivery of intergovernmental programs – that is to reduce prescriptive rules on how services are delivered through a focus on mutually agreed outputs and outcomes. While designed to give effect to the objective of the stimulus package, the approach adopted by the department has reduced the capacity of school systems to take account of system priorities and the differing needs of schools in their systems, within the Australian Government's policy parameters for the program. Additionally some of the administrative arrangements put in place by the department were unduly complicated and time-consuming for Education Authorities.[15]

10.17   The ANAO acknowledged that many of the issues that arose in the delivery of the program were a result of the 'compressed timetable for the establishment of the program, given the prevailing economic downturn' and did not make any recommendations.[16]

The Committee's review

10.18   The Committee held a public hearing on Monday 21 June 2010, with the following witnesses:

- Australian National Audit Office (ANAO); and

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14   The Australian Government provides Education Authorities with an administration payment of 1.5 per cent of total jurisdictional funding to cover the discharge of their responsibilities under the NPA.

15   Audit Report No. 33 2009-10, pp. 17-18.

16   Audit Report No. 33 2009-10, p. 18.

- Department of Education, Employment and Workplace Relations (DEEWR).

10.19   The Committee took evidence on the following issues:

- program rules;

- flexibility;

- costing;

- value for money;

- non-government schools;

- monitoring data;

- local labour; and

- progress to date.

Program rules

10.20   The ANAO noted that DEEWR had established a number of rules to govern funding applications from Education Authorities and that one of these rules required the Education Authorities to 'obtain agreement from school principals to decisions to allocate their school less funding than they were notionally entitled.'[17] The ANAO found that this rule effectively gave principals control over funding decisions in this area and affected the flexibility of Education Authorities to prioritise the use of funding.[18]

10.21   The Committee indicated that this is contrary to the usual order of decision making in Education Authorities and asked DEEWR why the rule had been put in place. The Department explained that, while it was aware that the underlying objective of the program was to promote economic stimulus in every community across Australia, it wanted to ensure that principals had the final say in what happened in their school.[19] DEEWR was concerned that the speed with which the BER had to be implemented to fulfil the stimulus requirements would led to Education Authorities putting forward projects that did not satisfy individual school's needs.[20] The rule was designed to prevent this happening:

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17   Audit Report No. 33 2009-10, p. 99.

18   Audit Report No. 33 2009-10, pp. 99 and 103.

19   Mr Manthorpe, DEEWR, p. 14. All references to witnesses' evidence comes from the Committee's hearing into this audit dated 21 June 2010, with page numbers relating to the Proof Committee Hansard.

20   Ms Paul, DEEWR, p. 15.

> There was some quite early media of principals in Victoria who were not agreeing with what their Education Authorities were putting up. That is why we introduced this step. We wanted some assurance, if you like, from principals that they were in accord [with the proposed project].[21]

10.22   The Committee noted that the rule applied when an Education Authority decided to allocate less funding than a school was entitled to and asked why such a decision would be made. DEEWR provided a number of examples where this might occur:

> It may simply have been a project which cost less. ... It could have been because it was a newish school, and so that school did not actually need a multipurpose hall or a library, but there could have been a school nearby which was really quite old and needed a much, much larger project.[22]

Flexibility

10.23   Members of the Committee were particularly interested to find out whether or not the program had been flexible and adaptable to the needs of individual schools. DEEWR cited two local examples to demonstrate the flexibility of the program with regard to special needs schools:

> In one case, there was a hall that had been extended, and a whole lot of fantastic technology and other things had been brought to bear to make that facility effective for the school community. In the other, there was a very significant degree of refurbishment for a young children's special school involving a lot of bathroom work and a whole lot of stuff to do with the particular needs of young disabled children.[23]

10.24   Members of the Committee were aware of anecdotal evidence where school communities had co-contributed to projects under the program to ensure that the school got exactly what was required. The Committee asked if the Department had any data on the extent of co-contribution projects. DEEWR informed the Committee that 1,101 P21 projects involved co-contributions.[24]

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21   Ms Paul, DEEWR, p. 15.
22   Ms Paul, DEEWR, p. 16.
23   Mr Manthorpe, DEEWR, p. 21.
24   DEEWR, submission no. 7, npn.

10.25   Table 6.1 shows a number of examples of co-contribution projects
         provided by the Department to the Committee.[25]

Table 10.1   Examples of co-contribution P 21 projects

Government	Example
NT Government	**Elliott School** is receiving $850,000 for the construction of a covered outdoor facility for learning and other school activity. The application identified that enrolments have steadily grown and there is a significant demand for a covered outdoor learning space. The project is strongly supported by the School Council and a co-contribution amount of $300,000 was identified bringing the total funding to $1.15m for the project.
Victorian Government	**Dingley Primary School** is receiving $2.5m for construction of a multipurpose building including a combination of library, gymnasium, halls, classrooms or administration offices. Co-funding with the State government of $2.5m was identified bringing the total project funding to $5m.
NSW Government	**Epping West Public School** is receiving $3.02 million for the construction of a new library under the P21 element of the BER with a co-contribution amount of $314,924. NSW DET advises the school wishes to add a classroom to the approved library project, to meet increased enrolments. The revised project amount is now $3,334,924 and the additional funds are being provided by the school.
ACT Government	**Amaroo School** is receiving $3 million for an extension to the library under the P21 element of the BER with a co-contribution amount of $400,000 to improve project outcomes. The total value of the project at the school will be $3.4 million. The multipurpose building includes six additional classrooms and a large central shared area.
ACT Government	**Harrison School** is receiving $3 million for the construction of a new multi purpose building under the P21 element of the BER with a co-contribution amount of $400,00 to improve project outcomes. The total value fo the project at the school will be $3.4 million. The multi-purpose building will include six classrooms and an adjoining outdoor shade structure. Bifold doors will fold completely out of the way to give access from the Performing Arts Building to a paved area outside, allowing for a performance or presentation to use the doorway as a stage while the audience uses the paved area as outdoor seating.

10.26   The Committee asked DEEWR if there were any constraints on the
         program that prevented it from being as flexible as other programs
         administered by the Department. DEEWR identified the need for speedy
         implementation to met the program's stimulus objective as the chief
         constraint on the program and provided two examples:

> ... under our existing capital grants program, we allow education
> authorities up to a year for planning and there is no real deadline

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25   DEEWR, submission no. 7, npn.

> on the construction, but we have an expectation of around three years. Clearly that was entirely unviable because of the stimulus objective. Secondly, under our capital grants program we allow, for example, block grant authorities and other education authorities the capacity to meet their own priorities ... which could well involve ... an education authority ... concentrating a given year's investment ... in a particular region. ... That was unviable too, because of the stimulus objective, which was for jobs to be created or maintained in every community. So we explicitly rejected that part of our existing time frames.[26]

10.27   DEEWR added that more onerous reporting requirements had also provided some constraints on the flexibility of the program as education authorities were asked to supply more information than the standard reporting requirements.[27]

10.28   Members of the Committee expressed concern that the systemic oversight of the program by DEEWR could have constrained individual principals who wished to advocate a project that did not fit within the parameters of the list of building priorities. The Department reiterated that the program allowed sufficient flexibility to accommodate the objectives of both schools and education authorities.[28]

Costing

10.29   The Audit Report noted that the BER program was originally costed at $12.4 billion but was increased to $14.1 billion after take-up of the program exceeded expectations. The ANAO was advised that the Strategic Priorities and Budget Committee of Cabinet (SPBC) were aware that the original costing 'represented only 90 per cent of possible expenditure' for the program.[29]

10.30   The Committee asked DEEWR why the program went to $14.1 billion. The Department told the Committee that the original calculation was based on the premise that a majority of schools would take up only 90 per cent of the funds on offer. However, a high level of schools took up their full entitlement and this resulted in the extra expenditure:

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26   Ms Paul, DEEWR, p. 23.
27   Ms Paul, DEEWR, p. 23.
28   Mr Manthorpe, DEEWR, p. 29.
29   Audit Report No. 33 2009-10, p. 110.

> ... the difference between the $12 billion and the final estimates variation was simply the difference between a 90 per cent envelope and more or less 100 per cent.[30]

Value for money

10.31   The ANAO expressed some doubt that established benchmarks had provided a useful basis for monitoring the use of funding.[31] The Committee asked DEEWR for assurance that the Commonwealth is receiving value for money for projects constructed under the BER.

10.32   The Department explained that value for money on a project-by-project basis is the responsibility of the Education Authorities but accepted that DEEWR is responsible for ensuring that overall value for money is achieved for the Commonwealth.[32] The Department maintained that it had been concerned about value for money from the beginning of the program and told the Committee that bilateral agreements with states and territories 'captured the notion of value for money' in a variety of ways.[33]

10.33   The Committee asked for specific evidence that value for money is being achieved. The Department admitted that it could not provide definite evidence of value for money until each project was acquitted but maintained that it was satisfied that the procurement processes put in place for the program are providing assurance of value for money.[34] DEEWR explained that the steps in place ensure that each project is scrutinised and that areas of concern are identified and rectified:

> You go through many steps: you go through the step of tendering, and we kept a very close eye, for example, on some education authorities which felt that they were not getting value for money and needed to re-tender because in one region or another there might have been – as they saw it – overheating. Or, for example we also kept very close tabs in some regional areas where labour was hard to get and so on.[35]

10.34   In light of DEEWR's assertion, the Committee asked ANAO to clarify its findings to the effect that there was insufficient data to establish if the Commonwealth was receiving value for money. The ANAO

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30   Ms Paul, DEEWR, p. 19.
31   Audit Report No. 33 2009-10, p. 135-36.
32   Ms Paul, DEEWR, p. 24.
33   Mr Manthorpe, DEEWR, p. 24.
34   Ms Paul, DEEWR, p. 27.
35   Ms Paul, DEEWR, p. 27.

acknowledged that the audit was conducted early in the program's life and had looked at the estimates for projects, before implementation.[36] The ANAO conceded that more up-to-date information may give a clearer picture of whether or not value for money is being achieved:

> They were early estimates and, obviously, as you go through a construction process [you] get greater clarity, that material was not up to date at the time when we conducted the audit. So there might be more current information.[37]

Non-government schools

10.35   The Committee noted anecdotal evidence and media reports regarding allegations that money invested in non-government schools was being used more effectively than money invested in government schools.[38] The Committee asked DEEWR to comment on this issue.

10.36   DEEWR indicated that the allegations were the subject of an inquiry by the Building the Education Revolution Implementation Taskforce appointed in April 2010.[39] The Department told the Committee that the allegations were being made before the actual cost of projects are known and that projects would need to be looked at on a case by case basis to determine value for money and effectiveness:

> A lot of the commentary about the costs of state schools in some jurisdictions is commentary that is based on estimates not actual, so we may find that actual costs in some cases are lower than expected. Then there are a variety of other conditions at play in any given case that might give rise to costs being higher than one might have expected whether it is to do with demolishing buildings that had asbestos in them in order to make way for the new classroom or what have you. There are a multitude of factors that can bear on that ...[40]

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36   Mr McPhee, ANAO, p. 25.

37   Mr Cahill, ANAO, p. 25.

38   See for example Natasha Bita, 'Catholics get more from BER', *The Australian*, May 21, 2010, and Jodie Minus, 'Catholic school undercuts BER costings', *The Australian*, June 1, 2010.

39   Mr Manthorpe, DEEWR, p. 29.

40   Mr Manthorpe, DEEWR, p. 29. For further discussion of this issue see Senate Education, Employment and Workplace Relations Legislation Committee Estimates, Official Committee Hansard, 3 June 2010.

10.37   The Committee notes that the Taskforce released an Interim Report on 6 August 2010 and that a Final Report is expected to be provided to the Minister in November 2010.[41]

Monitoring data

10.38   The ANAO identified a number of data integrity problems including collection and interpretation.[42] The Committee asked DEEWR if steps were being taken to improve the range and relevance of the data being collected by the Department.

10.39   DEEWR told the Committee that the Department was expecting Education Authorities to collect more data for this program than for the monitoring of any previous program. The Department indicated that, in addition, the Coordinator-General was demanding more data as was Mr Orgill, the head of the Building the Education Revolution Implementation Taskforce.[43]

Local labour

10.40   The Committee noted anecdotal evidence suggesting that local builders were not being employed to undertake P21 projects but that outside contractors were being brought in. The Committee expressed concern that this practice would not provide the intended stimulus for the local economy and asked DEEWR if it was aware of any evidence to support these claims.

10.41   DEEWR informed the Committee that the data collected by the Education Authorities did not 'indicate whether or not the jobs were occupied by local people.'[44] However, the Department noted that the ANAO survey of primary school principals found that the majority of principals believed that P21 projects were supporting local employment.[45]

Progress to date

10.42   The Committee acknowledged that the ANAO audit had been undertaken very early in the program and that, at that stage, actual expenditure was

41   The Interim Report is available on the Building the Education Revolution Implementation Taskforce website at: http://www.bertaskforce.gov.au/pages/default.aspx.

42   Audit Report No. 33 2009-10, pp. 124-151.

43   Ms Paul, DEEWR, p. 30.

44   DEEWR, submission no. 7, npn.

45   DEEWR, submission no. 7, npn. See also Audit Report No. 33 2009-10, p. 192.

low. The Committee sited the Coordinator-General's progress report from February 2010 indicating that completion rates were 'tracking slightly behind interim milestones' but were expected to catch up during 2010. The Committee asked for an update on completion rates and tracking against milestones.

10.43   DEEWR told the Committee that:

> As at 31 July 2010, 85 per cent of Primary School for the 21st Century projects have met or are expected to meet their target completion date or approved varied completion date.[46]

Conclusion

10.44   The Committee acknowledges that the audit was undertaken early in the program's implementation and that a full assessment of the effectiveness of the program will have to wait until the P21 projects are completed and acquitted. The Committee is concerned about the data integrity issues identified by the ANAO and urges DEEWR to ensure that these are addressed and that relevant and sufficient data is collected to enable the program to be monitored and evaluated.

10.45   The Committee recognises that the primary objective of the BER program was to provide economic stimulus during the global financial crisis and understands that rapid implementation was necessary to achieve this goal. However, the Committee is concerned that the governance arrangements put in place by DEEWR to facilitate the rapid implementation of the program may have compromised the ability of individual schools to obtain value for money.

10.46   The Committee is aware that DEEWR has faced considerable scrutiny over the BER program in addition to the ANAO audit, including a Senate inquiry and the Building the Education Revolution Taskforce inquiry. The Committee expects that this scrutiny will ensure that DEEWR will address the issues of concern identified by these inquiries for the benefit of future such programs.

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46   DEEWR, submission no. 7, npn.

Robert Oakeshott MP
Committee Chair
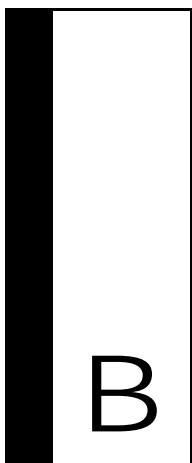
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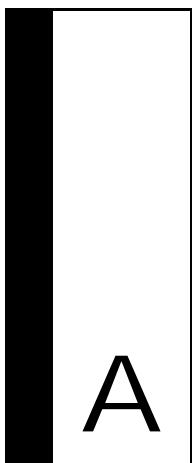
Appendix A – List of Submissions

Review of Auditor-General's Reports Nos. 4 to 21 (2009/10)

1   Australian National Audit Office

2   Australian National Audit Office

3   Australian National Audit Office

4   Department of Broadband, Communications and the Digital Economy

5   Australian National Audit Office

6   Australian Customs and Border Protection Service

7   National Health and Medical Research Council

8   Australian National Audit Office

Review of Auditor-General's Reports Nos. 22 to 38 (2009/10)

1   Australian National Audit Office

2   Australian National Audit Office

3   Australian National Audit Office

4   Australian National Audit Office

5   Department of Infrastructure, Transport, Regional Development and Local Government

6   Department of Climate Change

7   Department of Education, Employment and Workplace Relations

8 Department of the Environment, Water, Heritage and the Arts

B

Appendix B – List of Public Hearings

Review of Auditor-General's Reports Nos. 4 to 21 (2009/10)

Thursday, 11 March 2010 - Canberra

Australian Customs and Border Protection Service

> Mr Joseph Attanasio, Chief Information Officer
>
> Ms Jan Dorrington, National Director, Passengers Division
>
> Mr Timothy Patmore, Director, Enabling Operations
>
> Mr Terence Wall, National Manager, Passenger Operations

Australian National Audit Office

> Mr Matt Cahill, Group Executive Director, Performance Audit Services Group
>
> Mr Grant Caine, Senior Director, Performance Audit Services Group
>
> Mrs Barbara Cass, Executive Director, Performance Audit Services Group
>
> Dr Tom Clarke, Executive Director, Performance Audit Services Group
>
> Ms Celine Roach, Senior Director, Performance Audit Services Group

Department of Broadband, Communications and the Digital Economy

> Ms Marianne Cullen, First Assistant Secretary
>
> Mr Peter Harris, Secretary

Wednesday, 17 March 2010 - Canberra

AusAID

> Mr Jamie Clout, Deputy Director-General, Operations Policy and Support Branch

> Mr Laurie Dunn, Assistant Director-General, Operations Policy and Support Branch

Australian National Audit Office

> Mr Matt Cahill, Group Executive Director, Performance Audit Services Group

> Mr Steve Chapman, Deputy Auditor-General

> Dr Tom Clarke, Executive Director, Performance Audit Services Group

> Mr Stuart Turnbull, Acting Executive Director, Performance Audit Services Group

Thursday, 22 April 2010 - Canberra

Australian National Audit Office

> Mr Steve Chapman, Deputy Auditor-General

> Mr David Crossley, Executive Director

Australian Taxation Office

> Mr David Butler, Second Commissioner, Change Program and IT

> Mr Greg Dark, First Assistant Commissioner, Change Program

> Mr Michael D'Ascenzo, Commissioner of Taxation

> Mr Bill Gibson, Chief Information Officer

> Mr John Ryan, First Assistant Commissioner, Change Program

> Ms Raelene Vivian, Chief Operating Officer

Wednesday, 12 May 2010 - Canberra

Australian National Audit Office

> Mr Matt Cahill, Group Executive Director

> Mr Steve Chapman, Deputy Auditor-General

Ms Alex Geue, Audit Manager

Mr Steven Lack, Executive Director

National Health and Medical Research Council

Prof Warwick Anderson, Chief Executive Officer

Mr Tony Krizan, Strategic Finance Officer

Dr Clive Morris, Deputy Head and General Manager

Review of Auditor-General's Reports Nos. 22 to 38 (2009/10)

Monday, 21 June 2010 - Canberra

Australian National Audit Office

Mr Brian Boyd, Executive Director, Performance Audit Services Group

Mr Matt Cahill, Group Executive Director, Performance Audit Services Group

Dr Tom Clarke, Executive Director, Performance Audit Services Group

Mr Ian McPhee PSM, Auditor-General

Dr David Rowlands, Audit Manager

Mr David Spedding, Audit Manager, Performance Audit Services Group

Department of Education, Employment and Workplace Relations

Mr Michael Manthorpe, Deputy Secretary, BER

Ms Lisa Paul PSM, Secretary

Mr Stewart Thomas, Branch Manager, BER Strategic Management Group

Department of Infrastructure, Transport, Regional Development and Local Government

Mr Richard Farmer, Acting Executive Director, Nation Building - Infrastructure Investment

Mr Alex Foulds, General Manager, South East Roads