LEGISLATIVE ASSEMBLY FOR THE AUSTRALIAN CAPITAL TERRITORY

# REVIEW OF AUDITOR-GENERAL'S REPORT NUMBER 8, 1996

*Australian International Hotel School*

**STANDING COMMITTEE ON PUBLIC ACCOUNTS**
Report Number 23

December 1996

## RESOLUTION OF APPOINTMENT

The Standing Committee on Public Accounts was appointed by the Legislative Assembly on 9 March 1995 with the following terms of reference:

(a) examine:

(i) the accounts of the receipts and expenditure of the Australian Capital Territory;

(ii) the financial affairs of authorities of the Australian Capital Territory; and

(iii) all reports of the Auditor-General which have been laid before the Assembly;

(b) report to the Assembly, with such comments as it thinks fit, any items or matters in those accounts, statements and reports, or any circumstances connected with them, to which the Committee is of the opinion that the attention of the Assembly should be directed;

(c) inquire into any question in connection with the public accounts which is referred to it by the Assembly and to report to the Assembly on that question; and

(d) inquire into and report on the implementation of the *Public Sector Management Act 1994* with particular reference to:

(i) the public interest; and

(ii) any other related matter.

## MEMBERSHIP OF THE COMMITTEE

Mr Bill Wood MLA (From 26 March 1996. Elected Committee Chair 3 April 1996)

Mr Trevor Kaine MLA (Deputy Committee Chair)

Ms Lucy Horodny MLA

Ms Rosemary Follett MLA (To 26 March 1996. Former Committee Chair)

Secretary: Bill Symington

# 1. INTRODUCTION

### *Background*

1.1. Auditor-General's Report No 8, 1996 was presented to the Assembly on 26 September 1996.

1.2. This is a performance audit of the establishment and operations of the Australian International Hotel School (AIHS).

1.3. The AIHS was formally established in 1994 within the Canberra Institute of Technology (CIT) Act 1987 as an autonomous academic institution. The School is intended to be a self-funding degree-granting hotel management educational institution. The AIHS is affiliated with the School of Hotel Management at Cornell University in the USA under a Memorandum of Understanding which provides for Cornell to assist the School in areas such as curriculum development and international recognition of the AIHS degree.

1.4. The audit objectives were to provide opinion on whether:[1]

- the establishment of the AIHS was implemented in accordance with Government decisions
- design and construction processes for the AIHS building and site works were effectively managed
- the early operations of the School conformed with projections and other data provided to the Government during the establishment decision-making process
- financial arrangements for establishment costs and operating losses are appropriate
- AIHS fees are comparable with other similar service providers
- AIHS management is delivering services efficiently
- the latest independent assessment on the viability of AIHS operations used appropriate methodology and was based on relevant, accurate and complete information, and whether current AIHS operations are consistent with the independent viability assessment

The audit also included an assessment of the future viability of the AIHS and commented on the appropriateness of the governance and senior management structure of the AIHS.

1.5. The audit did not extend to an assessment of the quality, or the delivery, of the AIHS educational program, and the audit report stressed that nothing in its findings could be construed as a criticism of the quality of the AIHS educational program or its delivery.[2]

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[1] Audit Report, p3
[2] ibid, p1

1.6. The audit was conducted against the background of significant losses by the School in the years ended 31 December 1994 ($3.3m) and 31 December 1995 ($5.1m) and further major losses through 1996.[3]

1.7. In December 1992 when in-principle approval was given for the AIHS the establishment and initial operating costs were estimated at $12.5m. In April 1993 when firm approval to establish the School was given these costs were estimated at $16.9m and the maximum loan was set at that amount. The maximum loan was increased to $20.4m in December 1993 as a result of escalating costs and was further increased to $27.8m in August 1995. The actual amount owing at 30 June 1996 was $23.1m.[4]

1.8. The Hotel Kurrajong was acquired for the AIHS and extensively refurbished at a total cost of $11.785m.

## 2. COMMITTEE APPROACH

2.1. The committee sought comment on the audit findings from the Minister for Education and Training. The Minister provided the committee with a Government response incorporating an Action Plan. The next section of this report discusses the audit findings and the Government responses to those findings and material provided by the Minister in the Action Plan is also discussed in that section.

## 3. AUDIT FINDINGS

3.1. In summary, the audit found that:[5]

- in most respects the establishment of the AIHS was in accordance with Government decisions
- management was generally poor in relation to cost control towards the end of the Hotel Kurrajong refurbishment
- overall assumptions and amounts used as a basis for initial projections about the operations of the AIHS were badly estimated
- the financial structure was not appropriate for the AIHS which required significant initial capital
- the cost per AIHS student is very high in comparison to other hospitality and/or hotel management courses in Australia, except for Bond University which is slightly higher

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[3] ibid, p2
[4] ibid
[5] ibid, pp4/13

- in light of low enrolments, management has contained costs through 1995-96

- if the financial viability report prepared by consultants in June 1995 had projected enrolments closer to levels actually achieved, it is likely their conclusions would have been different

- on the basis of current level of borrowings, current expenditure patterns and enrolments AIHS will not be commercially viable in the foreseeable future. However, if it is not required to meet interest payments AIHS may cover operating costs after several years

- a statutory authority or Territory Owned Corporation with a board and full-time chief executive would be a more effective and accountable arrangement than the existing structure.

3.2. The audit also assessed a number of potential alternatives regarding the AIHS. These included continued operation of the School with funding of the annual operating shortfall until such time as student enrolments generate sufficient revenue to cover costs, partial or complete sale of AIHS or the Hotel Kurrajong to an investor or another educational institution, close the AIHS and sell the Hotel Kurrajong, replace the Government loan with private borrowing, and introduction of some private sector capital. The audit was not prepared to recommend how the future of the AIHS should be decided but acknowledged that determining the AIHS future would not be a simple task.[6]

3.3. In a general response the Minister for Education and Training advised that the audit report vindicated the Government's concerns about the AIHS, which had led it to commission an independent consultant to review the School's operations. The Minister advised that the consultant's report had temporarily allayed concerns but that when the Government became aware of continuing low enrolments it had no alternative but to ask the Auditor-General to assess the viability of the AIHS.[7]

3.4. The Minister further advised that the Government is investigating the development of a new capital structure for the AIHS which will involve a debt to equity ration that provides a reasonable base for viability. The Government is considering retiring debt or converting to equity all or part of the debt.[8]

3.5. The Minister also advised that as a first step the Government has appointed an interim Management Advisory Board to develop strategies to improve AIHS financial prospects with the Board focussing on boosting student numbers, more cost effective marketing, options for a wider range of programs and services, reviewing the high cost of a degree, and investigating affiliation with an Australian University.[9]

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[6] ibid, p119
[7] Minister for Education and Training, letter to committee dated 17 November 1996
[8] ibid
[9] ibid

3.6. The committee was advised that legislation to make AIHS an independent statutory corporation with strengthened accountability and reporting requirements will be introduced later in 1996.[10]

*Implementation of Establishment Decisions*

3.7. The audit noted that the overall decision to establish the AIHS was made mainly through three sets of approvals between 23 December 1992 when in-principle approval was given through to 19 April 1993 when it was agreed to provide up to $16.9m as a repayable advance being $13.8m for acquisition and refurbishment of the Hotel Kurrajong and $3.1m for establishment and operating costs. It was also agreed that up to $2m be provided to match private sector contributions, and that commencement of building works be conditional upon agreement with an international partner. A later Government decision increased funding to $20.4m.[11]

3.8. An agreement with an international partner, Cornell University, was reached in September 1993, although the audit found that, on the basis of advice from the ACT Government Solicitor, it is arguable whether the conditions required to commence refurbishment work had actually been satisfied at the time of work starting.[12]

3.9. The audit noted that the Memorandum of Understanding made with Cornell University contained an agreement that affiliation fees payable to Cornell would be some $2m in excess of the amount included in earlier submissions and financial projections although these were later ratified by the Government.[13]

3.10. While the audit found that in most respects the establishment of the AIHS was in accordance with Government decisions, in some cases Government approval ratified actions already taken.

3.11. As indicated above, the Minister for Education and Training advised that the Government is now investigating AIHS affiliation with an Australian university to further enhance the School's academic standing. The advice included that a more comprehensive and transparent system of reporting through the Financial Management Act 1996 will provide a framework for the proposed management board to operate within broad controls imposed by Government which will include monthly reporting to the Treasurer and reporting against criteria for measuring the efficiency and effectiveness of the AIHS.[14]

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[10] ibid
[11] Audit Report, pp29.30
[12] ibid, p31
[13] ibid, p25
[14] Minister for Education and Training, op cit

### *Hotel Kurrajong Refurbishment Cost Over-Runs*

3.12. The audit noted that the cost over-run against the approved budget for refurbishment of the Hotel Kurrajong was $685,000 or 6%. The reasons for this included generally poor cost control management, incorrect forecasts of estimated costs, lack of incentive for the managing agent to reduce costs, and a large number of variations made close to the conclusion of the project which resulted in a backlog of processing and reporting of variations.[15]

3.13. The Minister for Education and Training acknowledged the audit findings and advised that the development of full project briefs prior to work commencement should prevent time and cost over-runs for future projects.[16]

### *Early Operations Compared with Projections*

3.14. Comparison between actual operations and projections made before the commencement of operations supporting the establishment of the AIHS led the audit to the opinion that overall assumptions and amounts used as a basis for initial projections were badly estimated. The audit found that the ability to attract enrolments was significantly over-estimated in initial projections, that costs of establishing the AIHS were significantly under-estimated, the costs of affiliation with Cornell University were significantly under-estimated, the significant increase in estimates for enrolments and tuition fees presented in support for the increase of $3.5m in funding sought in December 1993 was not financially justified by the increased involvement agreed with Cornell University, and the costs of refurbishing the Hotel Kurrajong were under-estimated.[17]

3.15. The audit concluded that if projected revenue and other estimates had more closely approximated actual levels the financial projections would have indicated the project was not viable in terms of the AIHS being able to repay its debt within a reasonable time-frame.[18]

3.16. The Minister for Education and Training agreed that pre-commencement projections were badly estimated and had proved to be unrealistic. The Minister advised that future financial management decisions by the proposed management board, and by the interim board, will be based on projections supported by objective data and analysis. As noted above, the committee was advised that the Government is seeking to affiliate with an Australian university with a view to keeping costs to a minimum, and that any AIHS affiliation will need to be financially beneficial.[19]

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[15] Audit Report, pp35/46
[16] Minister for Education and Training, op cit

[17] Audit Report, pp7/8
[18] ibid, p8
[19] Minister for Education and Training, op cit

3.17. The Minister further advised that under new arrangements project briefs will be fully developed and costed before commencement and this should prevent unforeseen contractual variations in the construction phase and eliminate time and cost over-runs.[20] While the committee notes and accepts this reassurance, it is less sanguine that the new arrangements attaching to projects will eliminate unforeseen variations as, by their very nature, they are unforeseen. Future project management arrangements must be capable of controlling such changes.

### *Arrangements to Finance the AIHS*

3.18. The audit found that the AIHS financial structure with only interest-bearing debt funding and no equity was not appropriate for a venture requiring significant initial capital investment.[21]

3.19. As mentioned above, the Minister for Education and Training advised that the Government is considering a capital structure for the AIHS involving a debt to equity ratio that provides a reasonable basis for viability. This could include releasing AIHS from part or all of interest and loan repayments by retiring debt or converting debt to equity. The Minister advised that the conversion of debt to equity would assist AIHS to compete with other institutions offering similar courses as these other bodies have substantial fixed capital. The committee was advised that the management board will be asked to implement significant cost reductions and tighter expenditure controls.[22]

### *Comparison of AIHS Fees to other Institutions*

3.20. The audit found that AIHS fees are very high by comparison with other hospitality/hotel schools, except for Bond University. The AIHS degree course costs some $59,000 [which includes accommodation for one academic year] while courses which are offered by other universities and which could be seen as alternatives for an AIHS degree course cost less than $7,500. The audit noted that AIHS fees are comparable with overseas universities.[23]

3.21. The Minister for Education and Training advised that the Government accepted that the high cost of an AIHS degree is reducing the School's ability to attract enrolments from Australia and overseas. The Minister advised that the interim management board would be asked to review the fee structure to take account of the Commonwealth Government's move to introduce full fee paying higher education Australian students, and that the review will be one component of an overall examination of AIHS education services which will include options for a wider range of programs and services to make the School more competitive.[24]

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[20] ibid
[21] Audit Report, p65
[22] Minister for Education and Training, op cit
[23] Audit Report, p72
[24] Minister for Education and Training, op cit

*Efficiency of Operations*

3.22. The audit found that while management had contained costs through 1995-96, the high capital investment in relation to the small size of the AIHS and Hotel Kurrajong operations will continue to generate a higher fixed component in its cost structure than other institutions providing similar services.[25]

3.23. The Minister for Education and Training advised that the Government will ensure that the AIHS builds on gains made in 1995-96 with the highest priority given to the introduction of better management controls and a reliable financial management system.[26]

***Consultants Report on Viability, Future Viability of the AIHS and Future Financial Arrangements***

3.24. Before approving increased funding for the AIHS to $27.8m in mid-1995, the Government sought an independent consultant's report on the viability of AIHS future financial performance. As the assessment was positive, the audit examined the assessment. The audit finding included that if the consultant had projected enrolments closer to levels actually achieved it is likely the conclusions would have been different.[27]

3.25. The audit also found that on the basis of the current level of AIHS borrowings, expenditure patterns and enrolments the School will not be commercially viable in the foreseeable future, although it may eventually become viable if it is not required to meet interest payments.[28]

3.26. The Minister for Education and Training advised that under the Government's financial management reforms the AIHS will in the future provide monthly financial reports to the Government and the management board will monitor enrolments and develop strategies to attract enrolments. The Minister also advised that the management board will develop an outputs based business plan with clearly defined performance measures and achievable targets.[29]

## 4. COMMITTEE COMMENT

4.1. The audit report draws attention to failings in the commission of what was, in principle, an imaginative and far-sighted initiative to take advantage of a perceived opportunity to

[25] Audit Report, p87
[26] Minister for Education and Training, op cit
[27] Audit Report, pp91/92
[28] Audit Report, p103
[29] Minister for Education and Training, op cit

maximise the potential for the ACT to meet a market demand for a high quality degree course in hotel management.

4.2. The failings in commission identified by the audit report, and the Government's response to the audit findings, are discussed in this report. The audit was timely. Indeed, the committee considers that an audit could have been made at a much earlier date when clear signs were emerging that the AIHS was encountering difficulties in reaching student targets and, as a result, was not generating sufficient revenue to meet capital charges and operating costs. Having made this point, the reality is that these matters are now history and the important issue is to ensure that the financial interests of the ACT community are protected against any further erosion.

4.3. The committee therefore accepts that the Government, having taken the decision to retain the AIHS as a viable institution, has indicated that reform measures are underway to redress the management problems which have contributed to the AIHS financial problems and to ensure that future projects are more tightly controlled at all levels of their inception and delivery.

4.4. Any reservations held by the committee about the Government's rescue and support proposals relate to the interim nature of several of the proposals and, in particular, the role of the interim management board. Accordingly, the committee will recommend that the Government expedite the establishment of the AIHS as a statutory body and the appointment of a quality board of management reporting on a regular basis to the Minister and with provision for the Assembly to be informed of developments within the School.

## 5. RECOMMENDATION

**5.1. The committee recommends that the Government, as a matter of priority, bring forward legislation to give effect to its expressed intention to establish the AIHS as a statutory authority, and that the legislation include provision for a permanent board of management for the AIHS and regular operational and financial reports to the Minister.**

Trevor Kaine MLA
Deputy Chair

20 NOV 1996