LEGISLATIVE ASSEMBLY FOR THE AUSTRALIAN CAPITAL TERRITORY

REVIEW OF
AUDITOR-GENERAL'S REPORT
NO 4, 1999

Financial Audits With Years Ending To 30 June 1999

STANDING COMMITTEE ON FINANCE AND PUBLIC ADMINISTRATION (INCORPORATING THE PUBLIC ACCOUNTS COMMITTEE)

Public Accounts Committee Report Number 24

June 2000

RESOLUTION OF APPOINTMENT

The Standing Committee for the Chief Minister's Portfolio was appointed by the Legislative Assembly on 28 April 1998 to examine any matter under the responsibility of the Chief Minister's portfolio. The Assembly also resolved that the committee perform the duties of a public accounts committee, specifically:

(a) to 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) to report to the Assembly, with such comments as it thinks fit, on 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; and

(c) to 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.

On 26 November 1999, the Assembly retitled the committee as the Standing Committee on Finance and Public Administration (Incorporating the Public Accounts Committee), omitted reference to matters under the responsibility of the Chief Minister's portfolio and included reference to women's affairs, Aboriginal and Torres Strait Islander issues, asset management, gaming and racing and any other related matter.

MEMBERSHIP OF THE COMMITTEE

Mr Ted Quinlan MLA Committee Chair

Mr Trevor Kaine MLA Deputy Committee Chair

Mr Greg Cornwell MLA

Secretary: Bill Symington

1. INTRODUCTION

1.1. The Auditor-General's report no 4, 1999 comments on financial reporting and accountability matters in the ACT Public Sector which came to light during the audit of agency financial statements for the 1998-99 financial year. The report also comments on the Territory's spending on capital works.

1.2. Major components of the audit report are comparisons against budget and the previous year's results of agency financial performances. Where appropriate an explanation for variances is provided

1.3. The audit noted a number of matters which called for response by the responsible Ministers and the committee received a Government submission dealing with these.[1] The more significant issues raised by the audit and the Government responses are indicated in the next section of this report.

1.4. The audit did raise a matter of considerable significance and concern in relation to consultancy services contracted by InTACT in 1996-97, 1997-98 and 1998-99 at a total cost of some $990,150. This issue has been a major focus of the committee's review and is dealt with in a separate section of this report.

2. SIGNIFICANT ISSUES RAISED BY THE AUDIT

Consolidated Financial Statements

2.1. **The audit noted that a matter of emphasis was included in the audit opinion in relation to the uncertainty of non-current asset valuations**.[2]

2.2. In response to this finding, the Government advised that the matter of emphasis included in the Territory financial statements related to the revaluation of Bruce Stadium and that it does not believe it was warranted due to the fact that the estimates used in the valuation were subjective and difficult to confirm through normal audit procedures. The future cash inflows and outflows against the initial investment (i.e. the cost of the redeveloped Stadium) over the next 30 years was analysed and the net present value of these flows was calculated. Based on this analysis, the net amount expected to be recovered through cash inflows and outflows arising from future operations of the Stadium was $14.4m less than the carrying amount of the Stadium.

2.3. The Government advised that the write-down is subjective and material within the account of Bruce Property Trust. However, the write-down represents less than 1% of the Territory's total non-current assets and is not considered (by the Government) to be material in the consolidated statements for the Territory.

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[1] Treasurer, letter dated 3 April 2000
[2] audit report p18

Territory operating loss

2.4. The audit found that:[3]

(i) **The Territory Operating Loss was $175m in 1998-99 compared with losses of $170m in 1997-98 and $153m in 1996-97, and a budgeted loss of $149m; and**

(ii) **The Operating Result before abnormal and extraordinary items improved by $16m (11%) from the loss of $147m in 1997-98 to a loss of $131m. The budgeted loss was $148m. The improvement over the previous year largely resulted from increased Commonwealth grant revenue of $32m;**

2.5. In response the Government advised that it has been working to ensure that expenditure is controlled and revenues increase as part of its strategy to achieve operating surpluses and that this will be achieved in the 2000-01 financial year with surpluses continuing and increasing across the forward estimates.

2.6. The Government claimed that the improvement over the budgeted operating result was mainly due to an increase in the revenue base for taxes fees and fines.

Public trading enterprise (PTE) operating result

2.7. The audit noted that:[4]

(i) **The Public Trading Enterprise operating result before abnormal and extraordinary items has fallen by 55% over the past three years from a profit of $75m in 1996-97 to a profit of $34m in 1998-99. While expenses have fallen significantly, revenue has decreased at a greater rate;**

(ii) **As most of the Public Trading Enterprise operating result and operating cash flows are derived from ACTEW, the full impact of deregulation on ACTEW could lead to a further decline in the PTE results; and**

(iii) **Cash flows from PTE operating activities have fallen from $140m in 1997-98 to $111m in 1998-99 due mainly to lower electricity sales by ACTEW.**[5]

2.8. The Government agreed with audit concerns about the impact of competition on the operating results of the PTE sector and advised that it had commissioned expert advice on the impact of market changes on the future viability of ACTEW and ACTTAB and that, in relation to ACTEW, it has been concerned particularly about trading losses experienced by interstate government owned electricity bodies. In relation to ACTTAB The Government expressed concern about its viability as a relatively small operation competing with privatised interstate TABs.

[3] ibid p29
[4] ibid
[5] ibid p47

Capital works expenditure

2.9. The audit found that[6]:

(i) Approximately $35m (30%) of the budgeted 1998-99 capital works expenditure was not spent; and
(ii) Budgets were underspent principally because of unforeseen delays in commencing projects and projects being approved without agreement on key elements.

2.10. The Government drew a distinction between underspend against the projected expenditure and appropriation, noting that projected expenditure included private sector financing, and off-budget financing of ACT Housing capital works. The Government advised that the $35.2m underspend included $9.5m for ACT Housing and that ACT Housing's capital works program is financed from Commonwealth/State Housing Agreement funds, not from the capital injection appropriations. The Government considers it to be important that the ACT Housing capital works program is not included in budget-funded capital works.

2.11. The Government went on to advise that the underspend identified by the audit included $3.1m for the Resources Recovery and Waste Transfer facility at Mitchell, which is to be financed by the private sector. The 1998-99 program also included a provision for the Government's commitment of $3m for infrastructure works at Acton Peninsula. While this project has been identified in the program, the nature and timing of works at Acton remains uncertain, and is dependent on Commonwealth timings.

Australian International Hotel School (AIHS)

2.12. The audit found that:[7]

(i) The AIHS is operating within the financial arrangements agreed with the Government which allow for a total of a further $2.6m to be provided to the AIHS over the next two financial years;
(ii) The AIHS is not likely to be profitable in the short to medium term; and
(iii) The School incurred an unrealised foreign exchange gain of $94,085 following the revaluation of the Cornell establishment fee as at 30 June 1999.

2.13. The Government advised that:

(i) A review is being undertaken to explore strategic options for the continuation of the AIHS, noting that negative publicity has complicated the efforts of the AIHS to move toward financial self-sufficiency;
(ii) It has taken significant steps to address the profitability of the AIHS and that restructuring the AIHS is based on achievable projections of student

[6] ibid p60
[7] ibid p88

enrolments with the goal of ensuring that the school would become profitable in the future;

(iii) Annual borrowings are reducing in accordance with the Statement of Intent. However, cumulative borrowings coupled with the current equity investment, will continue to reflect an increase until 2000-01 when the final Government loan will be available;

(iv) The Government's return from interest on borrowings during 1998-99 was $323,000 and will grow to around $500,000 in 1999-2000. Payments of rent and territory taxes, including payroll tax, will continue to make direct returns to the ACT Government for its investment; and

(v) The value of the Australian dollar against the US dollar will continue to cause fluctuations in relation to continuing payments of the Cornell Establishment Fee during each year.

Canberra Business Development Fund (CBDF)

2.14. The audit found that:[8]

(i) The Fund purchased an equity interest in a local firm for $300,000 in August 1998 and that the investment had been written down to $129,000 by 31 December 1998; and

(ii) The Fund manager had not prepared the financial statements of the Fund for the period ended 30 June 1999 at the time of the preparation of the audit report in contravention of the Deed of Trust that established the Fund.

2.15. The Government advised that CBDF invests in organisations where the initial costs of developing their ideas and proposals are likely to exceed the initial returns, the 1998-99 financial year being a prime example of this. In the period to 31 December 1998, CBDF incurred a write-down in the value of its sole investment at the time, reflecting the initial costs of developing an innovative idea set to benefit the ACT region. In the period to 30 June 1999, the returns from this investment had begun to materialise, and the value of the investment had increased by $65,000.

2.16. The Government further advised that at the time of tabling of the Auditor-General's report the draft financial statements for the period ended 30 June 1999 were still being finalised due in part to delays in the audit of the six monthly accounts.

CanDeliver Limited

2.17. The audit found that:[9]

(i) Large differences between the budget and actual revenue and expenses in 1998-99 were the result of a slower than expected rollout of Commonwealth outsourcing contracts;

(ii) The Company incurred an operating loss of $790,031 in 1998-99 with accumulated losses totalling $909,695; and

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[8] ibid p96

[9] ibid p110

(iii) **The company's current ratio is a matter of concern and will need to be monitored closely if the Company is not to experience liquidity difficulties.**

The Government advised that as a result of the slower than expected rollout of outsourcing contracts, ongoing losses and the failure to achieve the goals of the organisation, the decision has been taken to cease the operations of CanDeliver.

Cultural Facilities Corporation (CFC)

2.18. The audit noted that in 1998-99 the CFC received Government Payment for Outputs of $6.054m equating to a government subsidy of $20.95 per visitor/patron per visit to facilities managed by the Corporation.[10]

2.19. The Government advised that the subsidy was substantially less than the performance target of $25.76 included in the Corporation's 1998-99 Statement of Intent and the improved result was achieved by increasing the number of visitors to Corporation managed facilities with no increase in government payments to the Corporation.

Exhibition Park in Canberra (EPIC)

2.20. The audit found that:[11]

(i) **EPIC has made operating losses, before abnormal items, over the past three years of $248,000 (1998-99); $174,000 (1997-98); and $374,000 (1996-97); and**
(ii) **Excluding the Community Service Obligation Payment, EPIC's revenue decreased by 6.6% whereas its expenses fell by only 1.6%.**

2.21. The Government advised that:

(i) EPIC's operating losses are due mainly to large depreciation expenses of $538,000 (1998-99); $505,000 (1997-98); and $428,000 (1996-97) on a property base of approximately $16,300,000;
(ii) EPIC's revenue decrease in 1998-99 was due primarily to a change in contractual arrangements with a catering company where EPIC received all the catering revenues. These revenues were offset by a payment to the caterer for its services. Users of EPIC's facilities now make their own catering arrangements; and
(iii) In 1998-99, EPIC experienced an increase in the depreciation expense and some other major non-discretionary expenses (insurance, electricity and maintenance costs) which contributed to ensuring a smaller reduction in expenses.

ACT Forests

[10] ibid p132
[11] ibid p148

2.22. The audit noted that:[12]

(i) An unqualified audit opinion with an Emphasis of Matter was provided to the Minister for Urban Services on 1 October 1999. The "Emphasis of Matter" related to the existence of an inherent uncertainty regarding valuation of plantation growing stock;

(ii) In 1998-99 ACT Forests' operating loss before abnormal items was $1m which compares unfavourably to the budgeted loss of $673,000 and the previous year's loss of $178,000; and

(iii) ACT Forests has returned operating losses every year since 1991-92, and has budgeted for future losses until 2001-02.

2.23. In response, the Government advised that:

(i) A policy for the implementation of Australian Accounting Standard 35 "Self-generating and Regenerating Assets", and in-principle agreement has been reached between ACT Forests and the Auditor-General. The policy, which includes a modelling system for valuing all stock at a market value, is expected to be implemented by 1 July 2000 in line with the requirements of the accounting standard;

(ii) The main reasons for the worse than budget operating result included additional harvesting costs associated with export sales and the sale of lower quality logs for a lower profit margin, and increased expenditure on plantation establishment and maintenance required as a result of below average expenditure for a number of years. This work will improve the quality of timber being grown; and

(iii) Profits are dependent on achieving sales volume, demand, prices and programs for silviculture and plantation tending. ACT Forests has been progressively building up the volume of timber but this has a very long lead-time.

Department of Health and Community Care

2.24. The audit found that the Department's capital expenditure was $1.2m higher than budgeted because of under-estimation of costs on a project.[13]

2.25. In response the Government advised that the over-budget capital expenditure resulted from under-estimation of expenditure on the refurbishment of Howard Florey Centenary House for the Health Protection Service. This was due to the original budget estimate being prepared using a generic (not specific) cost base for a laboratory refurbishment. These estimates did not fully account for the costs of converting an old school to 'high-tech' accommodation. The higher cash requirement was managed through the portfolio's overall capital works program by utilising cash from the Canberra Hospital's capital works program, which had a delay in one of its projects.

HealthPACT

[12] ibid p153
[13] ibid p165

2.26. The audit found that HealthPACT has not been fully successful in managing its finances to its budget and for the third year actual expenses have exceeded budgeted expenses.[14]

2.27. The Government responded that expenditure for HealthPACT was $33,000 higher than budgeted mainly due to higher employee expenses, it being difficult to precisely predict the magnitude of employee expenses in an organisation such as HealthPACT with some 6 staff. In this instance the transfer-in of a single staff member from another Government agency added to an under-estimation of employee expenses since HealthPACT had to recognise significant leave entitlements of the new staff member as an expense. The committee finds it difficult to comprehend that the movement of a single staff member should have had such a significant effect upon the under-estimation of HealthPACT's budget.

2.28. The Government stated that HealthPACT's business as a community funding agency and initiator of health promotion projects is such that a variation of 1.3% is acceptable and is supported by a positive asset to liability ratio.

ACT Housing

2.29. The audit noted that:[15]

(i) ACT Housing did not comply with its policy on rental review periods; and
(ii) ACT Housing's capital works program was almost $10m below budget because of delays.

2.30. The Government advised that:

(i) ACT Housing policy provides for rent reviews every 6 months, except for certain types of tenants (typically pensioners) where reviews are conducted every 12 months. A significant factor in delays on rent reviews during 1998-99 was the replacement of the computer system that recorded tenancy management information. Some problems beyond the control of ACT Housing were experienced with the new system but these have now been fixed; and
(ii) ACT Housing's capital works program was under budget primarily due to unforeseen delays in development approvals (especially appeals) for large projects, and the refusal of two significant development applications. A more rigorous financial analysis of individual projects also resulted in some withdrawals.

[14] ibid p172
[15] ibid p175

Department of Urban Services

2.31. The audit noted that:[16]

(i) The expenditure budget for Territorial transactions particularly for depreciation and amortisation and administrative expenses was significantly under-estimated; and

(ii) The Department spent $416,000 against the budget of $889,000 for Departmental Capital Works, similarly only $21.2m was spent against the budget of $29.6m for Territorial Capital Works.

2.32. The Government advised that:

(i) Most of the variation in expenditure for Territorial transactions was due to depreciation, particularly on infrastructure assets. Depreciation on these assets was significantly under-estimated in the Budget because it was impacted by asset re-valuations and re-assessment of asset useful lives which occurred between the time of the budget and the preparation of final accounts. Re-valuations/re-assessments were in accord with Australian Accounting Standards and ACT Government Accounting Policies and they were not possible to predict with accuracy at the time the Budget was set. This situation may re-occur in the future but the Department has taken some action to minimise the magnitude of such variations; and

(ii) Underspending on Departmental capital works was primarily due to a delay in design of the Tidbinbilla Visitor's Centre which was not due for completion until December 1999. The variance in Territorial capital works was primarily due to two projects - Acton Peninsular infrastructure and Mitchell Resource Recovery Station. Funding for Acton Peninsula ($3m) was rolled over from the previous year as the nature and timing of works is entirely dependent on the Commonwealth's timeframes. The Mitchell Resource Recovery and Transfer Station ($3.1m) is to be financed by the private sector and the Government considers it inappropriate to be included in the budget underspend because of its private nature.

2.33. With regard to the Government's comment in relation to the Mitchell Resource Recovery and Transfer Station, the committee observes that the project should either be in the capital works program or not be in it. If it was part of the capital works program, as it appears to have been, the committee notes that appropriate provision would have been made for the expenditure whether or not it was to be privately financed.

[16] ibid p242

3. InTACT CONSULTANCY

3.1. The Auditor-General found that:[17]

(i) InTACT's operating loss for 1998-99 was $7.6m compared with a budgeted operating profit of $427,000 and the budgeted outcome was never realistically achievable;

(ii) Some $10m of $28m in borrowings for upgrading the Territory's IT infrastructure was used for other purposes; and

(iii) A contractor received payments of some $990,150 between 1996-97 and 1998-99 on the basis of an informal agreement with InTACT management and did not provide value for money.

3.2. The Government submission did not address these matters. However, in relation to matters (i) and (ii) the audit report incorporated a statement by the Chief Executive of the Chief Minister's Department that "InTACT's financial position has not been a stated measure of its performance. There has been a significant range of factors largely outside InTACT's control which have contributed to InTACT's financial results". The audit reported that no meaningful comparison of InTACT's operations can be made to its budget for the year, that the budget assumed optimistic levels of completion would be attained with regard to the modernisation program and that these were never realistically achievable.[18]

3.3. The audit report also noted a statement by Chief Executive of the Chief Minister's Department that "The 1998-99 InTACT budget assumed that the IT infrastructure modernisation project would be largely completed in that financial year. It is not conceded on that basis that at the outset the budgeted outcome could not be achieved".[19]

3.4. With regard to the payments made to a single contractor/consultant, the audit found these were made at a rate of $4,000 - $4,500 per day and were approved without documentation substantiating the services provided or the basis of the engagement. The audit noted that the contractor provided human resource management services which the audit adjudged did not provide value for money. [The engagement of the contractor was terminated by the Acting General Manager appointed following the resignation in June 1999 of the senior manager who had engaged the contractor.][20]

3.5. The Chief Executive of the Chief Minister's Department disagreed with the audit view stating that "this is the Auditor-General's view. I disagree. While the fees for this consultancy were at the high end of industry rates, these consultancy services contributed significantly to the maintenance of workplace relations harmony and effective change management at InTACT during a particularly difficult period for the organisation".[21]

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[17] audit report pp185/186
[18] ibid p190
[19] ibid
[20] ibid p189
[21] ibid p190

3.6. The committee is particularly concerned with the circumstances of the contract. The committee is further concerned that until it was apprised of the contract by the audit report departments were less than open and frank with the committee at a time when it was inquiring into the Chief Minister's Department Annual and Financial Reports 1998-99. The committee became aware of the contract arrangements as it was on the point of reporting to the Assembly on that inquiry and added a postscript to its report about the contract arrangements.[22]

3.7. During the annual reports inquiry Ministers and officials were questioned about expenditure for consultancy and contractor services with the committee drawing attention to payments to two companies, Utmost Pty Ltd of $411,150 and Zesta Pty Ltd of $340,750 for the provision of organisational change management services. At no stage of the hearings was the committee advised that the services provided by the two companies were in fact provided by the one individual contractor, the subject of this part of the audit finding, submitting invoices from both companies, nor was the relationship between the two companies and their sole proprietor revealed to the committee.

3.8. The committee subsequently pursued this matter with the Auditor-General and, later, with senior InTACT management.

3.9. The position is that the contractor, a consultant in human relations and strategic management, was engaged by a previous General Manager of InTACT on an informal basis without a contract or letter of engagement to specify the conditions of engagement and the types of services to be delivered by the contractor. As noted above, the Chief Executive of the Chief Minister's Department advised that the services contributed significantly to the maintenance of workplace relations harmony and effective change management at InTACT during a particularly difficult period for the organisation.

3.10. It is important to note that there was no paper trail outlining what the contractor was to do or did. Invoices were simply submitted every ten days or so indicating days worked and the amount owing on a per diem basis. A typical invoice is provided at attachment A. From inquiries by the Auditor-General it appears the contractor attended many meetings, gave courses, helped prepare briefings, assessed discussions and so forth. A reconstruction of documentation indicates that the contractor performed a range of tasks over the total period in question which, in the view of both the Auditor-General and the committee, any senior departmental official would be expected to carry out as part of their normal duties.[23]

3.11. The committee acknowledges the subsequent assistance of the present General Manager and the present Deputy General Manager (who was also the previous Acting General Manager) of InTACT in clarifying aspects of the contractual arrangement during discussions with the committee. The committee was assured that arrangements now in place would prevent a recurrence of the situation outlined above.

3.12. The committee has requested the Auditor-General to review relevant InTACT processes in due course. In the meantime the committee considers the government should fully examine the circumstances of the engagement of the contractor in this instance to

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[22] Report on Chief Minister's Department Annual and Financial Reports 1998-99, pp19,20
[23] Transcript public hearing 17 December 1999 p16 et seq and letter dated 28 January 2000 from the Auditor-General

determine the value and benefit of the total services provided and what, if any, recourse exists for recovery of any over-expenditure for the provision of the services involved.

4. COMMITTEE COMMENT

4.1. A consistent theme of these types of round-up audit reports is the underspend or under-achievement in capital works. Observation of the budget papers, for example, indicates inclusion of the same projects from year to year with sometimes not much apparent change in progress with those projects.

4.2. Apart from other important considerations arising from delays with capital works projects, the committee notes that significant cash balances may build up through unspent capital works funds with a temptation for an agency to use those funds for something else including operational expenditures.

4.3. Another concern is that the capital works program each year includes projects carried forward from the previous year or years, projects which were heralded in those years as initiatives the ACT community and business were encouraged to prepare for. In reality, net capital works programs include previously announced projects and projects which in some, if not many, cases are not expected to be completed or substantially advanced during the financial year in question.

4.4. The committee has indicated its position on the InTACT consultancy and awaits the outcome of further inquiries into the matter by the ACT Government.

Ted Quinlan MLA
Chair
June 2000