

# TRANSCRIPT

## ECONOMIC DEVELOPMENT AND INFRASTRUCTURE COMMITTEE

### Inquiry into local economic development initiatives in Victoria

Melbourne — 16 October 2012

#### Members

Mr N. Burgess  
Mr M. Foley  
Mr B. Carroll

Mrs I. Peulich  
Mr G. Shaw

Chair: Mr N. Burgess  
Deputy Chair: Mr M. Foley

#### Staff

Executive Officer: Mr S. Coley  
Research Assistant: Mr M. Newington

#### Witnesses

Mr D. Pearson, Auditor-General (sworn), and  
Mr D. Mischkulnig, Director, Performance Audit (sworn), Victorian Auditor-General's Office.

**The CHAIR** — Welcome to this all-party parliamentary committee hearing evidence in the Inquiry into local economic development initiatives in Victoria. All evidence taken at this hearing is protected by parliamentary privilege; however, comments made outside this hearing do not have the same protection. Your evidence will be taken down and become public evidence in due course. Could you please state your names and the positions you hold?

**Mr PEARSON** — Desmond Pearson, Auditor-General.

**Mr MISCHKULNIG** — Dallas Mischkulnig, Director, Performance Audit.

**The CHAIR** — Thank you. I invite you to make your oral submission.

**Mr PEARSON** — Thank you, Chair. We welcome this invitation. As Parliament's independent auditor I value all elements of the Parliament taking an interest in our work. While our primary oversight committee is the Public Accounts and Estimates Committee and there are statutory, consultative and oversight arrangements there, that committee has limited resources, and our remit is quite wide. I was proposing to give a brief overview of the role of the Auditor-General as background, and then I understand the primary area of interest for the Committee is our *Investment attraction* performance audit report. Dallas was the director who led that, and I propose asking him to give you a quick overview of that report and then very much at the Committee's convenience provide whatever assistance we can.

As the external auditor of the public sector and Parliament's auditor we are a relatively small office of 160 people, with a \$35 million-a-year budget. If you look at it functionally, we do about 60 per cent annual financial statement audits of the 570-odd entities that make up the state and local government sector in Victoria, and about 40 per cent of our resources go into a series of performance audits. Normally we table around 30 a year, and each performance audit is a significant body of work. In dollar terms it is probably about \$350 000 to \$400 000 worth of effort, and they typically take 9 to 12 months from inception through to reporting.

Under the Act we are required to table in Parliament annually an annual plan. For six years we have taken the Act as a minimum and mirrored the annual budgetary process, so in addition to providing an annual plan for next year's audits we provide three out years of forecast audits. That is both trying to avoid the stigma of auditors — —

**The CHAIR** — Excuse me; I hate to interrupt. I want to remind the press who are present that the focus is to be on the person speaking at the time and not on any of the other members unless they are speaking. Thank you.

**Mr PEARSON** — Why we forecast three years out — and effectively the plan is becoming a four-year rolling plan — is because that is designed selfishly to avoid the assertion that auditors are 'ambush people' who catch you by surprise — we give plenty of notice — but it is also an insurance policy that we do very broad consultation in picking the topics. That provides some level of assurance we are picking the right sorts of topics, because we have limited resources and the sector is quite large and diverse. But in the absence of people challenging our topics, that is as good an assurance as we are going to get that we are looking at the right sorts of issues.

When I look at the title of your Economic Development and Infrastructure Committee — another initiative we have done with the annual plan is when you can only look at, say, 30-odd topics a year out of the breadth of the Victorian public sector you have got to be very selective and risk based in picking them. What we have done over time is, with the current government and the Governor's opening statement to Parliament, looked at five particular areas of focus: a growing economy; services that work; strong families and vibrant communities; secure water and a healthy environment; and government you can trust. We used those as reference points to help us select topics and, given there were 30-odd topics, to try to get a bit of balance across those focus areas and the range of agencies and entities that comprise the Victorian public sector. It is a multidimensional and inexact science, but we are doing the best we can to synchronise and reconcile competing demands. We are being transparent about it so that if we overlook something, hopefully somebody else will identify and draw it to our attention and we can address it there.

That is the overview. I stress again that that is where I value these sorts of parliamentary committee inquiries using our work. As auditors we are the watchdogs, not the bloodhounds. We look at a high level in a risk-based manner and try to identify the matters of significance, draw them to attention and make recommendations. But

we have no executive authority, so once we have put the spotlight on it we are reliant on the executive to respond to our reports and acquit their responsibilities. But the crosscheck on that is the Parliament's oversight, and that is at a number of levels, from debates and questions through to committee inquiries and then PAEC putting it together. It is in that context that I value your interest, and I thank Mrs Peulich for suggesting it was worth having a talk to us.

**The CHAIR** — We are grateful to have you here.

**Mr PEARSON** — Unless there are any questions, I propose the best way forward, if the *Investment attraction* audit is the one you are interested in — —

**Mrs PEULICH** — There are two; I think we are also interested in your comments in relation to the local government audit and in particular the recommendations for improving performance measurement and reporting. If you could speak to both, that would be great.

**Mr CARROLL** — Possibly also *Managing major projects*.

**Mr PEARSON** — Will we do them in that order? We will do *Investment attraction* first.

**Mr MISCHKULNIG** — I will just go through some of the highlights that came out of the *Investment attraction* report that we tabled in Parliament on 15 August 2012. As the Committee is aware, the Government attracts investment primarily by developing a business environment that is attractive to investors; promoting the attributes of their region as an investment location; providing information and assisting investors, for example in selecting sites and acquiring statutory approvals; and in some circumstances providing financial assistance.

The Department of Business and Innovation was the focus of this audit; it was not investment attraction across all the areas of government. Particularly the trade industry and development division within DBI was one of the prime areas that we interacted with for this particular audit. As Victoria's lead economic development agency DBI tries to influence companies about where to invest once they have decided to invest. It tries to encourage investment in the competitive environment within Australia and outside of Australia with its competitors. It also works with different areas of state government to try to cultivate and advocate for business issues, reducing regulatory burden and so forth.

What we found during the audit was that Victoria has a number of challenges it has to face with respect to competitiveness. We identified some of the literature that showed that productivity growth had decreased in the last 10 years, that the resources boom in other states had pushed the Australian dollar up and caused upward pressure on exports and that population growth and urban development et cetera had created challenges for infrastructure. All those things impact on the environment and attractiveness of this state.

However, for over 10 years, the Government has recognised that there is a need to improve productivity, so we were interested in seeing how the Department went about addressing that particular area. The focus of the audit was on looking at the Department of Business and Innovation's investment attraction and facilitation programs, looking at whether it has had a strategic approach to that, the soundness of the business climate, its contribution to that and its advocacy role, whether it had robust processes in place for providing financial and non-financial assistance and how reliable and transparent the processes were for monitoring, evaluating and reporting on their activities in this space.

Investment attraction, as I said earlier, is about attracting new investments or encouraging existing businesses to further invest. We found that, as far as the business environment goes, creating a sound business environment within Victoria is critical to attracting investment, as is its effective promotion as an investment location. Victoria had a reasonably strong and stable economy and an attractive business environment for the last 15 years, and DBI's activities are likely to have contributed to that outcome.

DBI's advocacy roles appear to be working effectively; it has ongoing contact with local, state and Commonwealth government agencies. It makes representations on behalf of business, and it advocates for improving the business environment. Its promotional activities are reasonably well planned, organised and appropriately targeted on priority industries and investment markets. There are strategies DBI has put in place in relation to that that reflect the research and analysis that the Department has undertaken.

The Department developed a new business engagement model in 2010. That was introduced, and by the time the audit was tabled, was beginning to be fully rolled out within the Department. That model was to shift from looking at priority sectors to a broader consultation with business across the State, and it is expected to generate better business intelligence, improve resource allocation across business activities and focus on activities where there were key economic and sector-wide competitive issues that could be addressed, such as infrastructure, regulation, skills development et cetera.

It was underpinned by a new information management system that the Department had rolled out. Previously there were a whole lot of silos of activities, and a lot of information was not shared. This new system and this engagement model give the potential for the Department to more strategically analyse the information that it is collecting from this broader consultation process. Because it was so early in its operation, there is really no data and no ability for us to comment on that, but it appeared to be moving in the right direction as far as the strategic approach goes.

As I said, the Department's advocacy role was reasonable. It has participated in regulatory and other reform. It has representatives on ministerial, departmental, agency and national advisory investment boards, IDCs et cetera. It is clear from the OECD, the Productivity Commission and others that business environment creation is really the most important as far as making a location attractive for business. However, we also identified that government needs to understand the costs, the broad impact and the net benefits to the State of its various activities. To understand the costs and benefits, it needs to examine not just outcomes as far as new jobs, capital expenditure and exports go but also the impact on existing jobs, the impact on productivity improvements, the introduction of new innovation processes, the impact on tax revenues et cetera.

We also believe that formal evaluations of completed projects should be undertaken to see what those net benefits are, and there should be a greater disclosure publicly of criteria that are used: who gets what and what are the outcomes from those investments? The Department held the view that creating a sound business environment and promoting it was not sufficient, that targeted investment assistance is required to encourage and secure investment. This view was not universally accepted. Economic authorities believe that there is limited value in targeted financial assistance, so part of our focus was making sure there were comprehensive and robust processes associated with assistance provided through DBI's various programs. The State Government has a portfolio of industry assistance programs managed across seven different departments, and in 2010–11 we were informed that these programs provided around \$400 million worth of government assistance. DBI's contribution to that is about \$170 million, or 41 per cent. Assistance is provided for a range of purposes, including industry development, investment attraction, innovation technology and regional development. This audit focused on DBI, an area within DBI and its investment attraction activities.

In this context the Department provides both financial and non-financial assistance to companies, and it is clear that there has been an impact on generating benefits for the State in terms of jobs, capital expenditure and exports. However, as I mentioned before, the assessment criteria that are used need to have a focus on innovation and productivity — a real focus on that — and be able to demonstrate that these produce the best outcomes for the State.

As the Committee will be aware, productivity enhancements such as new technologies that increase the knowledge base and enhance local skills, and new management technologies that decrease relevant cost inputs are the sorts of things that we would expect would need to be examined through that sort of assessment. From 2008–11, roughly 336 projects received grants or non-financial assistance: 63 per cent in the Melbourne metro area and 37 per cent in regional and rural Victoria. Those projects were expected to generate benefits of \$8 billion in capital expenditure, create 18 000 full-time jobs and increase exports by \$1.5 billion.

There are multiple areas within DBI that are used to attract investment. We focused our attention on the Industry Support Program and the Industry Transition Fund. We did that because those are the main two grant areas within the Department. The Industry Support Program was established in 1993 and its purpose was the attraction of footloose businesses that offer significant economic benefits for the State and align with government policy. The Industry Transition Fund was a temporary fund set up for about 18 months from December 2008 until June 2010 in response to the global financial crisis to help companies during that time.

Over the three years to June 2011 the Government committed around \$230 million in grants through those two programs for 46 projects ranging from \$170 000 to \$40 million. We believe the eligibility criteria within those

two programs were reasonable, and they are articulated on page 38 of our report. However, there were issues in relation to the application of those. There was a lack of guidance to staff who used those criteria about which of those criteria were mandatory and how to go about assessing productivity and innovation. We looked a little bit more closely at 50 submissions between 2003 and 2011, and there are issues about which criteria were met, whether or not there was sufficient information to demonstrate which criteria were met or not met, what was the basis of the decisions that were being made. We were of the view that the Department should limit this financial assistance to those companies that meet eligibility criteria, particularly mandatory criteria. As different internal and external reviews of those programs have shown over the years, there needs to be a real focus on productivity and innovation, rather than just jobs, capex and exports. Those decisions need to be supported by appropriate documentation and transparency.

With respect to non-financial assistance, the Department has a policy that it will facilitate or assist any company that knocks on its door, but the degree of assistance is determined by their staff in the field and based on some loose criteria that is not documented. No decision-making process is formally undertaken. Services such as providing specialist advice on approval processes and licences, coordinating the state–federal government approval processes and identifying greenfield or existing sites — the degree to which that sort of assistance is provided is determined on a case-by-case basis by the people who interact with these different companies. Its facilitation services have never really been formally evaluated — the effectiveness of these.

In closing, one of the things we did a little bit differently in this audit compared to the previous audits the office had done is that previously we would focus just on the financial assistance and the assistance process. For this audit we were trying to understand it in the broader context of the range of investment attraction activities I mentioned before — developing the business environment, advocating and promoting that, as well as the facilitation. What we found, and one of the points of contention in the audit, was around the robustness of the strategic framework in which the different activities within the Department operate.

The Department contended that their corporate plan would provide sufficient direction and guidance for those activities. We were of the view that there needed to be more rigour and process around that, and a comprehensive investment attraction strategy should be put in place to understand the various objectives across those activities, to make sure they align with government policy and to make sure they are assigned responsibility, timeframes and evaluation processes et cetera associated with these. You will see in the report, in our recommendations, that we remain of the view that the Department needs to develop that sort of comprehensive strategy and have robust evaluations of its projects, in the assistance it provides to different departments, as well as more rigorous assessment processes and decision making around which areas receive government assistance. That is a snapshot of what the report is about.

**Mr PEARSON** — Mr Chair, did you want to have questions there or proceed on to talk about the other reports?

**The CHAIR** — Given the time, we might proceed to talk about the other reports and do the questions at the end, if that is all right.

**Mr PEARSON** — Okay. *Performance reporting by local government* was mentioned, and that is a report we tabled, if I recall correctly, in April this year. That was against the backdrop that the Local Government Act was amended in 2003 to require local government authorities to prepare performance statements and report on performance. We did an audit in 2008 and found that most councils' performance reporting lacked relevance to the communities as it did not cover outcomes, service quality or achievement of objectives. Because of that finding, we then proceeded to issue a better-practice guide; we basically converted our audit program into a better-practice guide to try to encourage and put on notice that we were going to do a more detailed performance audit, and that is what we have done in 2012.

We did it in 2012, and it had to be what I call a conceptual or theoretical audit to a large degree because the quality of performance reporting is pretty substandard. We examined a cross-section of 10 councils out of 78 to get a judgement sample of the spread of size and other things like that. Basically the conclusion we came to was that performance reporting remained focused on inputs and operating activities, so it told you how busy they were but not much about how well they were operating. There have been limited improvements we could note today, and we did not judge them to be sufficient to meet the information needs of ratepayers or to drive performance improvement.

We acknowledge that there are ongoing performance challenges in the sector and a need for more work. Let us not kid ourselves: the public sector is hard to report performance on because it is very subjective, but if you do not begin, you are never going to get anywhere on the journey.

**Mrs PEULICH** — It is an \$8 billion sector though.

**Mr PEARSON** — It is.

**Mrs PEULICH** — Surely it should more than just subjective.

**Mr PEARSON** — I come back to, in a broad thing, that in the private sector by and large if you look at a set of financial statements, it tells you how much, because the dollars are there, and how well, because it has a profit or loss at the bottom. In the public sector, even in local government, the financials only tell you how much, because you have the rating power — you just up the revenue. It is not like a competitive, commercial environment where you have regulators overseeing the operation. That is why the focus is on performance reporting.

Basically at this high-level conclusion we found there is a lot more work to be done. We were somewhat disappointed in the amount of work done to date, but we then took the audit to the next step of trying to suggest or develop a first-pass project as a starting point. We felt the Productivity Commission's report on government services model would not be a bad model for local government to embrace because you have to respect the individual autonomy of relevant local government authorities, but nevertheless they are part of the local government sector of Victoria, and unless you get a framework, each one's performance in isolation does not tell you a lot other than personal opinion.

Basically in the audit we looked at what were recurring performance challenges. We know them as ineffective planning and budgeting from a range of audits. We found deficiencies there: inadequate implementation of initiatives and adherence to policy and procedures, so again there was a good framework set up and good intentions but they were not followed through to delivery; weak oversight and monitoring of council activities and outcomes, and this is common more broadly to the public sector; and inadequate attention to addressing persistent performance issues. Those are the challenges we recognised they had to face.

When we looked at the quality of performance reporting to date — and this is against the backdrop of about nine years reporting, because it was an '03 legislative requirement — we found that it failed at the first pass in the sense in that objectives were poorly expressed. If you have not expressed your objectives well, how do you begin to assess? There was incomplete coverage of council objectives and key strategic activities, so when you have looked at it there were glaring gaps and omissions in what was there. There were a lack of indicators of outcomes and of efficiency of the council activity. There were a lack of adequate policies for performance reporting, so it was very ad hoc and dependent on individuals, and very limited training for councillors and staff had been provided.

Then we move on to the proposed framework, and, as I have already alerted, we were impressed with the report on government services' approach, where it works across the state and territory governments and across a range of areas. We felt that would be a good starting point. The key challenge to be overcome even in adopting that framework is to identify common services and objectives. Again, that is at a level that they are precise enough to be comparable but not so precise that they become incomparable and distracting.

There is a need to develop suitable indicators, and there are good standards around. Certainly in the accounting and auditing profession for performance indicators we have criteria tests for relevance of the indicator, appropriateness of the indicator and does it fairly represent performance. It is thinking: is it relevant to the appropriateness to the objective and then are the measures reasonable? Again, in terms of measuring performance, you measure against plans, past performance and like performance elsewhere. So you get into what I call benchmarking but bringing broader things in.

**Mrs PEULICH** — So it is attempting to move them from just the inputs — —

**Mr PEARSON** — Yes.

**Mrs PEULICH** — That perspective, to looking at the real outputs, not just what they think they are doing.

**Mr PEARSON** — That is right, and we cannot underestimate that there is quite a body of work to be done there.

**Mrs PEULICH** — Have they been receptive?

**Mr PEARSON** — Receptive, but it is early days. The report was tabled in April 2012, and this is an election year in local government, so realistically I do not expect to get — —

**The CHAIR** — The focus is elsewhere at the moment.

**Mr PEARSON** — Yes, so I am optimistic that there is buy-in and that once the elections are out of the way there will be some traction. There are positive signs out of Local Government Victoria and the Municipal Association of Victoria to forming working parties to work on it. It is an area where as an office, again, we have to be careful as the independent auditor. We are not consultants, and, as we want to say, we are the Auditor-General, not the ‘consultant-general’, because you have to draw that line as to how far we go. But we are prepared, given the significance of this, to cooperate in an observer capacity as they work it through.

I think it is such a big issue that it needs a structured approach, and I feel that we can provide consultative advice without getting too close to owning it and retaining our independence so that we can audit it later. Equally we have a wealth of knowledge that we have built up from a series of audits that — —

**Mrs PEULICH** — Because your auditing is frustrated by that lack of a framework.

**Mr PEARSON** — Yes, it is.

**The CHAIR** — That would have been why you made the exception and produced the first pass, was it, for them to base their approach — —

**Mr PEARSON** — Yes, really trying to prompt them into action.

**The CHAIR** — It was not coming from anywhere else.

**Mr PEARSON** — Again, just a bit of background — and I am not being critical here — there had been a reference to the Essential Services Commission and they had started out on an approach, but at a briefing I had there was a view that every local government authority was different. That just sort of struck me that — —

**Mrs PEULICH** — They are not that different.

**Mr PEARSON** — I know that they are different and they are autonomous, but — —

**Mrs PEULICH** — There might be different varieties of ice-cream, but it is still ice-cream.

**Mr PEARSON** — That is my view. Maybe I am easily persuaded, but personally I am a strong fan of benchmarking because we do it across audit offices. Arguably we are all different and we all have slightly different mandates, but the generic task is somewhat the same. There are different mixes, but — —

**Mrs PEULICH** — It has been an excuse for too long.

**Mr PEARSON** — I will let others judge, but I relate to that. It is more an avoidance and, ‘It is all too hard’, rather than, ‘It is hard. Let’s chip away and find a stepping stone to make some progress.’ It is hard to see much tangible evidence.

**The CHAIR** — Given the fact that you have really found yourselves in the position where you have had to put that forward, does that mean there has been an inappropriateness of being able to find that in the past?

**Mr PEARSON** — Yes, inadequate investment right across. I think that certainly the individual local government authorities are probably doing enough of their own, but it is not informed by looking wider.

**The CHAIR** — Yes, sure.

**Mrs PEULICH** — You mean the left hand does not know what the right hand is doing?

**Mr PEARSON** — That is right. But then you get within the current planning and community development area of the Local Government Victoria office, and, okay, it is a centrally coordinated area and it has some resource constraints — and I have not done an audit, so I cannot make an assertion — but you are left wondering: has it been purposely driven, have they taken a conscientious, responsible approach to assessing priorities and delivering resources to where they count? Maybe it is my original accounting training or something, but if you look at things systemically and have control totals and work through, you can pick the right things to look at that will get the Pareto principle. If you do the right 20 per cent, you get 80 per cent of the result. If you approach management in a purposeful way like that, it is going to be challenging, it is going to be hard and you are going to make some mistakes, but at least you can demonstrate you are going in the right direction.

**Mrs PEULICH** — And we are lagging about 10 years, aren't we? Because England has already moved in that direction and it really has led and increased the efficiency and effectiveness of local government, but we have not yet.

**Mr PEARSON** — It has, and again there are other jurisdictions. Western Australia, New Zealand and the ACT have universally stepped into performance indicator reporting. I have been part of that in the past and I think it is a significant contributor to performance reporting in the public sector, but it is not the total answer. However, it is certainly a quantum step in the right direction.

**Mrs PEULICH** — A stick.

**Mr PEARSON** — That was my once-over lightly on the performance reporting audit. If you want us to go into more detail — —

**The CHAIR** — No. We might — —

**Mr PEARSON** — The report is available — —

**Mrs PEULICH** — So how long will it take?

**Mr PEARSON** — Realistically, I think you are probably looking at three-to-five years. I stand corrected on this. We have been doing a limited audit and giving a clear opinion on their performance statements since they started in 2003 or 2004, but we are really only giving an opinion that the numbers add up. We have signalled that from 2014–15 we are going to do a full audit on relevancy, appropriateness and fair representation.

**Mrs PEULICH** — That is 2014–15?

**Mr PEARSON** — Yes. We are putting in an imperative that they need to get their act together, because from 2014–15 we will be able to qualify and, as an auditor, say, 'You cannot rely on that'. We are trying a bit of the carrot and a bit of the stick.

**The CHAIR** — We might just start on questions now, if that is okay. I will start with the first one, if that is alright with the Committee. Given that you are thinking three-to-five years for implementation, could you just give us an overview of what you would see the landscape being after five years in an ideal world? What is Utopia for you?

**Mr PEARSON** — Utopia for me would be the ability to have these concise performance statements up on a website so that as a citizen you can compare your local government authority with an equivalent one in different respects. There would be some aspects you could compare on size, some on geography and some on circumstance — that sort of thing. But it is really providing relevant information, and it is a fine balance between not drowning the community in data but providing meaningful information that addresses the core issues. I find it hard to answer you on local government, but if we go to a bit of a hard area like health and human services, it is a very debatable area. It is: how do you work back? I would have thought you would fairly quickly get to a concurrence of view that maybe length of life and quality of life are probably your primary indicators. It is: how do we get that in the relevant area?

**The CHAIR** — And how does that wash down through the various things?

**Mr PEARSON** — And how does it wash down? What are the contributors? And in turn that will inform your tactical interventions and things like that.

**The CHAIR** — Does that model exist?

**Mr PEARSON** — No. To be fair, we in the Western world are leading it, and in Australia there are elements. The UK is probably more advanced in the benchmarking, but I see that as an opportunity for us to piggyback that.

**The CHAIR** — A lot of work has been done.

**Mr PEARSON** — A lot of work has been done. Take that, and then step forward from that. It is not for me to comment on the UK, but it is probably a risk because their local government is in some respects different to ours. There has been the demise of the Audit Commission over there. In the 1990s the Audit Commission certainly was an outstanding example of doing audit assessment and meeting a range of criteria, and then the financial people just followed through and did their annual financial work, but they test against that criteria and then they report it using a league table benchmarking approach. Some people avoid league tables and benchmarks, but I think that as long as people focus on them as indicators of performance and are aware that they are not absolutes, it gets the debate back to the area that matters. Utopia to me would be local government down to three-to-five headline indicators and probably three-to-five sub-indicators of each.

**The CHAIR** — And to be able to drill down for the information that has led to those conclusions.

**Mr PEARSON** — That is right.

**Mr FOLEY** — Just noting the constrained time we have got — —

**The CHAIR** — We did start late, though.

**Mr FOLEY** — With your looming retirement — and on behalf of the Parliament of Victoria, congratulations on six years of hard work — could I ask you to reflect on what further powers you think your office might need so as to ensure the kind of goals you have spoken about here, which the legislation talks about and which inquiries like ours need to get to to have quality information to make serious recommendations to the executive for change?

**Mr PEARSON** — The two threshold ones for myself would be that there are very strong secrecy provision in the current Audit Act to the extent that in effect I cannot work meaningfully with the Ombudsman, other accountability officials or other audit officers in other jurisdictions. In today's world, with COAG reforms and that, we are mixing things up, so there is an increasing need for us to share and collaborate with our professional colleagues, whether it be as fellow accountability officials or other auditors.

The other big one is what we as auditors term the 'follow-the-dollar powers'. The Audit Act was written in the era when effectively everything was done by the public service. There were strong access-to-information and premises provisions, but increasingly now we are outsourcing service delivery by alliance contracts, straight outright contracting and public-private partnerships. I have a strong view that the legislation has to come up to speed with that, because my contention is that established standards of public sector accountability should not be dependent on the means of delivery. They should be dependent on the taxpayer funding them. If the taxpayer is funding service delivery using a private sector partner, I do not want the right to audit the partner but I want the right to access the partner's records and assets relevant to the service delivery to the State.

The easiest example of this for me is the on-time running of public transport in Victoria. You have private providers running trains and private providers running trams. As an auditor, to do that, I would need access as of right to things like the timing points in the train system to ascertain the reliability of the source data collection and its compilation into reports.

**Mrs PEULICH** — Are those powers available to other auditors in other jurisdictions?

**Mr PEARSON** — Most, now. There has been a round of legislative reform across the country. The Commonwealth, Western Australia, Tasmania, Queensland and I think the Australian Capital Territory have all done it. There are a few.

**Mr FOLEY** — And they have been contained in your annual report recommendations to the Parliament?

**Mr PEARSON** — Yes. There has been a Public Accounts and Estimates Committee inquiry and there is a long list of about 38 recommendations, but to me those two are the real — —

**Mr FOLEY** — In terms of this inquiry, with its focus on local economic development, would you see the same principles applying to local government and regional development groups et cetera?

**Mr PEARSON** — In what way do you see the principles?

**Mr FOLEY** — In terms of the two main powers — follow the dollars — —

**Mr PEARSON** — To be able to audit them? Yes.

**Mr FOLEY** — Do you see much in local government of that outsourcing of the partnership arrangement?

**Mr PEARSON** — Yes. It is right across the public sector. In fact I think it is an issue — and it is on the public record — that the Commonwealth audit legislation has gone a step beyond what I see as necessary. That legislation has been effectively that — there might be some challenges to it — under that law the Commonwealth auditor can come and audit Victoria if we are using Commonwealth funds.

**Mr FOLEY** — Special purpose grants and so on?

**Mr PEARSON** — Yes. Any Commonwealth partner the auditor can go and audit. So it is not just other government — state or local — it is private providers.

**Mrs PEULICH** — So if the thrust of our inquiry — and there seems to be a fairly strong push amongst submissions — is to look at how the different levels of government can collaborate, especially when it comes to funding, you are saying that that then is part and parcel of this new age where you have three levels of government chipping in funds but you need to be able to audit. Is it just top-down or is it bottom-up as well?

**Mr PEARSON** — I think it should be both ways. And that is why I think we have to open it up, respect the way things are being done now and, from my point of view, give the auditors the discretion to professionally arrange among themselves who is the most appropriate to do it or whether we want to share. We might want to do different aspects of it, but at the moment that is tightly constrained and Victoria probably has one of the tightest pieces of legislation that constrains that ability to cooperate.

**The CHAIR** — Do you find that used as a barrier — the fact that there is a third-party private enterprise involved when you are trying to audit through?

**Mr PEARSON** — You are going to get me into trouble, Chair. Invariably I find that — —

**Mr FOLEY** — You have privilege.

**Mr PEARSON** — You are being a little bit harsh. It is more a barrier that is driven by vested interests within the public sector. I find, generally speaking, that when there is a commercial contract we will go and talk to the private party and they are generally open and reasonable, but the managing department tends to want to protect its interests and say, 'Hey, you shouldn't be talking to them. They haven't got the power'. And again that is the way, unfortunately, human nature and accountability can rub. So it is wanting strong and firm powers, and I would argue that there is a very long history and tradition of audit exercising those powers very responsibly and only using them when absolutely necessary. But by the same token if you do not have them, it is futile.

**The CHAIR** — That is fully understood.

**Mr CARROLL** — Thank you for the presentation. It is very worthwhile. Just getting back to that top-down and bottom-up approach, the *Managing Major Projects* report that was handed down to the Parliament last week noted that every major project in Victoria has to have a local government area, and this committee is looking at the role of local government in economic development. I do not know if local government was in the report much at all, but how does Major Projects Victoria interact with local government? I know that most of

the projects would be with the City of Melbourne, but you could say, for example, that with the fast rail to Tullamarine airport, you will have the city of Yuroke up the top end there, Moonee Valley Council and a whole series of local governments along the track.

**Mr PEARSON** — That was not part of the scope of the audit. That was very much an audit of the operation of Major Projects Victoria, and our fundamental finding was that they were not able to demonstrate how well they were operating. When we drilled down we found that what they were reporting as performance just did not stand up, and when we drilled further down they had records management problems and they were using contractors without justifying, so there were a range of those issues. But coming to that issue, I think you would probably have to talk to them about that.

To be fair, while we were quite critical of their project management and housekeeping, they did have some good achievements, and while we did report their level of being over time, over budget and things like that, there are very few large and complex capital works projects that come in under time and under budget. So you have to bring a rational approach to it, but what we were coming at is that if you do not deal in facts and deal with reality, how can you purposely manage? But I think you would find — again not an audit review but an observation — that when you look at the range of projects they have delivered, albeit mainly in the Melbourne area, the same skills would be applied reasonably in dealing more broadly. It is a real issue of breaking down the silos within the respective bureaucracies; that is a real issue.

**Mrs PEULICH** — And sometimes it is keeping local government out so they can actually get some things done, like happened in Dandenong.

**Mr PEARSON** — Yes.

**Mrs PEULICH** — Otherwise nothing would have ever happened.

**Mr PEARSON** — Yes — revitalising. That is right. There were a couple of other reports we had in mind just to draw your attention to. *Revitalising Central Dandenong* was one in that category, and there is one coming up on managing the provincial Victoria growth fund that we are currently working on, which we are due to table before the end of this year, so it is an audit in course. Again, that is one that looks at what the enablers are and what needs to be done to achieve the right outcome.

**Mrs PEULICH** — The picture you are painting us is that there seem to be a lot of resources and a lot of opportunities probably squandered, not accounted for and not fully exploited for local economic development activity through local government in particular.

**Mr PEARSON** — Yes. It is a real challenge in large and complex organisations, which the public sector is. State and local government employs close on 300 000 people. It is 570 entities. I argue that the Victorian public sector is the third-largest business in the country.

**Mrs PEULICH** — Yes, and growing.

**Mr PEARSON** — Yes, but if you look at your BRW top 200 companies, okay, the banks would beat us on assets, but the retailers do not beat us on employees. And when you look at revenue and assets, Victoria has about \$220 billion or \$240 billion worth of assets, while the BHPs and Rio Tintos are struggling to get into that league. We are dealing with a very large and complex organisation. So to me it is as much the human element as the process element, and that is one of our real management challenges.

I do fear — and I will share this — that as auditors we are accused of highlighting exceptions, but I remind people that, generally speaking, 90 per cent of our reports are a positive assurance while the 10 per cent exceptions get the attention. That will be the same in your parliamentary business: the exceptions get the attention. I think that is something we have to deal with. In one sense, for efficiency purposes, we probably run down the public sector, and I, as a career public servant, wonder whether it is coming time to reinvest in it and skill-up. But in skilling-up we also have to focus on encouraging public servants to manage risk rather than avoid it, and a common problem with large and complex organisations is that you get into process and human nature becomes pretty good at following process but forgetting why the process was in place.

**Mrs PEULICH** — Losing sight of the outcome.

**Mr PEARSON** — Yes. Process is used as a tool, not a master, and you need to understand why it is there and what is your outcome.

**The CHAIR** — Hence your carrot and your stick.

**Mr PEARSON** — Yes, and again my passion about performance is that if you have not got an objective, how can you begin to measure the extent to which you are getting there?

**The CHAIR** — Gentlemen, on behalf of the Committee thank you very much for your evidence today. It has been gratefully accepted. You will receive a transcript in about a fortnight. Please feel free to make typographical changes but nothing to the substance of the document. Once again I thank you on behalf of the Committee for being here.

**Mr PEARSON** — Thank you, and it has been a privilege to be able to give some evidence. If there is something you think we can help you with, out of session, you can contact us.

**Mr FOLEY** — I think we should take the opportunity to note the contribution over the past six years that you have made and wish you all the best with the next chapter in your career.

**Mrs PEULICH** — Absolutely; likewise. That is echoed right around. Thank you.

**Witnesses withdrew.**