VERIFIED TRANSCRIPTS

PUBLIC ACCOUNTS AND ESTIMATES COMMITTEE

Inquiry into Victoria's Audit Act 1994

Melbourne—29 April 2010

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Mr R. Barr, Deputy Secretary, Corporate Services and Development,

Ms R. Martin, Director, Legal, Audit and Risk,

Mr D. Kirtley, Chief Internal Auditor, and

Mr A. Shavitsky, General Counsel, Department of Innovation, Industry and Regional Development.

The CHAIR—I declare open the Public Accounts and Estimates Committee hearings on the inquiry into Victoria's Audit Act 1994. On behalf of the committee I welcome from the Department of Innovation, Industry and Regional Development Mr Alf Smith, acting secretary; Mr Rob Barr, deputy secretary, corporate services and development; Ms Rosemary Martin, director, legal, audit and risk; Mr Adrian Shavitsky, general counsel, and Mr Dan Kirtley, chief internal auditor. Members of the public and the media are also welcome.

In accordance with the guidelines for public hearings, I remind members of the public that they cannot participate in the committee's proceedings. Only officers of the PAEC secretariat are to approach PAEC members. Departmental officers, as requested by the acting secretary, can approach the table during the hearing. Members of the media are also requested to observe the guidelines for filming or recording proceedings as they would if in the Legislative Council committee room.

All evidence taken by this committee is taken under the provisions of the Parliamentary Committees Act and is protected from judicial review. However, any comments you make outside the precincts of the hearing are not protected by parliamentary privilege. There is no need for evidence to be sworn. All evidence given today is being recorded. Witnesses will be provided with proof versions of the transcript to be verified and returned within two working days of receipt. In accordance with past practice, the transcripts and any PowerPoint presentations will then be placed on the committee's website.

I now pass to the acting secretary and his team for any opening comments. Committee members will ask questions relating to the inquiry into the Audit Act and we will probably take it in turns in order to ask those questions. I ask that mobile telephones be turned off as well. Thank you.

Mr SMITH—Thank you, Chair. As the Victorian government department with a significant direct relationship with the private sector, the Department of Innovation, Industry and Regional Development wishes to make a number of points in relation to the current inquiry by the committee. In particular, I would like to talk about the relationship between government and the private sector. The government has had extensive relationships and dealings with the private sector for many years. These relationships cover a very wide spectrum, including commercial transactions, regulatory oversight and/or monitoring and investment attraction and facilitation, to name just a few. Commercial transactions by themselves also cover a very wide range, such as purchasing goods ranging from stationery to cars to specialist equipment; purchasing services, ranging from services purchased directly by the government through to services provided by the private sector to the community on behalf of government; delivering projects and attracting investments.

Given this very broad range of relationships between the government and the private sector, it is the view of this department that any change to the current legislative arrangements should be considered carefully to ensure that an appropriate balance is maintained between the need to ensure proper and efficient use of public resources and the private sector's need to ensure appropriate confidentiality around its intellectual property, commercial relationships and the like. At the moment, DIIRD believes that we deal with this matter in a contractual sense. In our purchasing contracts with a value of over $50,000 or more, the department has access rights in respect to the goods and services delivered, so the department or its representatives can go in and ask for certain audit requirements that are specifically for the goods and services that are the subject of the contract.

However, for funding agreement contracts, there are wider access provisions and most of these specifically name the Auditor-General as having an access right under these contracts. We feel by doing it that way we can get the contractual requirement to meet the risk or the size of the contract. If we are purchasing stationery we basically have no rights; if we have a

larger purchasing agreement, we have some rights regarding the services provided; in terms of funding, we have a wider audit access right. That way we believe that we protect the state's interests, the department's interests and the community's interests. There is a balance.

The CHAIR—What do you mean by 'access rights'?

Mr SMITH—We have a right to inspect the books and to seek information. That is my understanding.

Mr SHAVITSKY—Depending on which type of transaction we are talking about, for the funding agreements we have quite extensive rights and we also reflect the rights that exist in the legislation for the Auditor-General so we double-up by adding that into a contract. That allows us to go in quite extensively and audit. For the contract engagements, for purchases of goods and services, we have the right to go into their premises and access their records pertaining to the services being delivered. It is not something that we would need to call upon often if we are just engaging—

The CHAIR—Can you give us some examples of these?

Mr SHAVITSKY—Certainly.

The CHAIR—Samples of what you—

Mr SMITH—I do.

The CHAIR—What you are talking about is a gradation.

Mr SHAVITSKY—Correct.

Mr SMITH—Yes.

The CHAIR—While it is not possible for us to look at the absolute gradation, could we assume that anything over $100 million you would have quite extensive access rights for, or $1 billion, or what?

Mr SMITH—Our funding agreements, I think, have much higher access rights and, as I said, the commercial contracts would vary, because something over $100 million, most certainly if it were for a specific contract, would not be using standard contract forms. It may be, but usually if you are buying $100 million worth of goods and services—

The CHAIR—So that is an example, is it?

Mr SHAVITSKY—This is a sample of a range of them.

Mr SMITH—It is a specific purchase you are requiring.

The CHAIR—Obviously, there are a number of examples there: $50,000. In terms of these samples, there is Skills Victoria—it would be nice if they answered some of their questionnaires; there are councils, industry grants. These are examples, but is there a manual that you have that specifies when these types of access arrangements come in, either by type of agency, or type of contractor, or level of contract?

Mr SMITH—I will refer you to Adrian in a moment. I think there are two we have in purchasing goods and services, where we are directly purchasing—I think the cut-off is below $50,000—we use a short-form contract for efficiency and that does not have an access

right. Over $50,000 it does. Under the funding agreements, I do not think there is a size limit on funding contracts, is there?

Mr SHAVITSKY—That is correct.

The CHAIR—Sorry, it is a bit hard hearing you.

Mr SMITH—On a funding contract, where we are providing funding to organisations, we have the higher level access and that applies virtually irrespective of size.

The CHAIR—Okay.

Mr SHAVITSKY—The gradation that you refer to is not referable necessarily to the amount so much as the nature of the transaction.

The CHAIR—Is there a specific guideline, not quite regulation? Are there Treasury and Finance directives on this? Do you see what I am getting at? Is it just an internal practice?

Mr SHAVITSKY—The way that we manage that process is that, for instance, we have a template contract form that sits on our intranet, and that is the form that is used. So inasmuch as anyone goes outside to engage an external party, it has built into it that access right that we speak about. That is for the contractor engagement. The grant agreements we draw up through our own office, so we control it that way.

The CHAIR—You don't actually have a procurement guideline? There must be something. There is, isn't there? There are Treasury procurement directives.

Mr SHAVITSKY—And we reflect those in our contracts.

The CHAIR—Right. But what do they say about this?

Mr SMITH—They have similar—

Mr SHAVITSKY—For the government.

MR SMITH—Yes.

Mr SHAVITSKY—We have a shorter form which we have modified. Most departments, because of the different areas in which they operate, have got their own versions of it. I have not brought the generic form because we do not use them, but they would have like provisions.

Mr SMITH—So the Treasury set broader principles when we take those.

The CHAIR—What you are saying is that the procurement guidelines are just principles? It sounds a bit vague to me. It sounds as if you can do what you like.

Mr SMITH—No, sorry. Perhaps I have used the wrong word. They would set processes, guidelines and instructions which are followed. For smaller purchases, departments have the ability to use shorter forms.

The CHAIR—We understood that.

Mr SMITH—For the longer form contracts, most departments would modify them to deal with the particular types of issues they are dealing with and the particular types of

services and goods they are providing, but these clauses would be more generic in nature and would be reflecting the Treasury templates.

The CHAIR—That is a useful introduction. There are a lot of other issues to follow up.

Mr RICH-PHILLIPS—Is there any resistance from the private sector entities you contract with to the inclusion of these access clauses?

Mr SMITH—It varies. I will ask Adrian to expand on that in a moment. Where we are acquiring goods and services, there are some firms that are concerned about the breadth of the clauses we use. On the funding contracts we basically say, 'That is a condition of the funding arrangement, so if you want the funding you live with the requirements.'

Mr RICH-PHILLIPS—And on the procurement contracts?

Mr SMITH—On the procurement contracts there has been and sometimes that is negotiated.

Mr SHAVITSKY—That is right. With the procurement contracts, that is the area that we will encounter in the negotiations. This is very occasionally amongst the last things that rile particular organisations and it relates to where we would engage, for instance, the accounting consultancy type firms to produce an economic forecasting report and an individual within the firm would have the capacity to produce the report and do the research. If we purport, as our generic provision does, to have the right to audit a bit more broadly than that—and it does relate to the services but it also enables us to go and look at their PC and the machinery that they use to generate documents—then they might resist that. That is one instance where we would concede that, if all we are asking for is an economic consultancy report from the KPMGs and Deloittes of the world, to ask to walk into their premises to look at the PC that they are using to produce that report is probably a little bit excessive for the sake of a relatively confined consultancy.

Mr SMITH—Certainly in some sections of the private sector there is a concern about the breadth of the clauses we use.

Mr RICH-PHILLIPS—In practice, do you exercise your rights under these audit access clauses?

Mr SMITH—We have access right under the funding agreements. I am not aware that we have under the standard purchase ones.

Mr SHAVITSKY—I think that is fair. I can only speak for as long as I have been there, which is over a decade, but I am not aware that there has been the need to go in for the types of engagements that we have talked about, certainly for the funding arrangements. I was speaking to one area of the department this morning in the workforce area. They have gone in actively to investigate their suspicion of fraud. There was no resistance to complying with the obligations under the agreement and they conducted an extensive audit which showed up a fair bit.

Ms MARTIN—We were considering this ourselves: how often do we use those provisions? How often do we need to use them? In what circumstances might it arise?

The CHAIR—Hopefully never.

Ms MARTIN—Hopefully never. You have it there as a safeguard. The instance

where you might seek to make more active use of your right to go in and inspect/audit would be where the entity with whom you are contracting is looking to be financially insecure or in some financial difficulty. But the other reality is that, if you do have an issue to do with the provision of goods or services, your first port of call is less likely to be to seek to audit what they have given you and is more likely to take the form of some other dispute resolution. So you are more likely to have some form of either formal or informal negotiation to seek to resolve whatever the dispute is, and it would be a more particular kind of problem that we do not have a great deal of experience with in our dealings, as Adrian has indicated, where you would be looking at having recourse to those very specific provisions. Having said that, they provide a very important safeguard when we are doing business and procuring goods and services from third parties.

Mr RICH-PHILLIPS—The department does not see them as a standard mechanism by which you can audit contract performance, and you do not exercise them as of right, as a matter of course?

Mr SMITH—There are a lot of other provisions in the contract around contract performance. These provisions are there as a safeguard if required but are not usually used, as Rosemary has just indicated. If we have an issue about the quality of the services being provided, or we think there is an issue, we would have discussions first, we would go into a dispute resolution process second, and try to solve the issue by those means. In fact, these means will not usually help solve an issue about the quality of the service being delivered. If they think they have done a good job and we think that the report they are providing, for example, is not up to the standard we would expect, that is not something that these audit provisions are really going to help us on. It is about the quality of work, and the specification of the services to be provided would be the area that you would be having debate and discussions around.

Mr RICH-PHILLIPS—What about in the area of funding agreements? I assume a fairly basic funding agreement would require the entity that is receiving funding to report back to the department against the targets?

Mr SMITH—That is right. Again, it would be in the context of those targets or the financial reports they are providing and, I think as just indicated, it is only where you think that there is an irregularity or there is a concern about the viability of the company or some other aspect that you would use those provisions rather than the other provisions of the funding agreements.

Mr RICH-PHILLIPS—You do not engage in a sampling audit to determine whether the reports you are receiving are in fact an accurate reflection of—

Mr SMITH—We would find that through other means. Often they are self-evident, because sometimes it is known or you can go and see. In a lot of our funding agreements we have regular contact with companies in other ways and we have regular contact with the industry, which is also a good source of information. Again, it will depend on the purpose. We certainly monitor the funding agreements to make sure that we are getting the outcomes we expect. In fact, a lot of our funding agreements pay on outcomes; they are not in advance. It is self-correcting in that sense.

Mr RICH-PHILLIPS—Using one of those examples—an investment facilitation; a particular target of employment—how would you assess that? The company would report back, 'We've employed X number of people against our target.' How would you verify that is actually true?

Mr SMITH—There are a range of ways that could be done: visiting the company

directly; talking to some of the workers in the company: if necessary, checking payroll tax records.

Mr SHAVITSKY—In fact, we even go a touch further than that. We do have that right. As a matter of course, we require through our funding agreements—which I have not provided to you there—provision of audit reports by the companies themselves to certify the information they have provided. We have two tiers of checking of the material that is provided to us. We have now made the directors personally responsible. They sign directors certificates. Those directors certificates are audited and provided to back up the figures that are provided to us, and we have sat down with accounting firms to get the audit certificates—audit opinions, as they are called now—to a level that is as high a bar as we can set.

If, for whatever reason, that still does not meet our needs, we have these supplementary rights to go in on top of that. What happens in that situation is that, if we get something that does not look quite right for whatever reason—and we tend to get pretty good information coming from the audit firms because they know if they are going to treat with government that we want to get reasonably robust information from them—we do alert the organisations receiving funding of our rights, but we would prefer that they go in a bit harder and provide more information for us. So it is actually a bit of a tool by which we can sit down with them and make sure that they come to the table more openly.

Mr RICH-PHILLIPS—Taking your earlier comments that it is only very occasionally that you have had resistance to these provisions, why would it not be appropriate to enshrine these in legislation rather than rely purely on the contractual arrangements you have?

Mr SMITH—The advantage of a contractual approach is that it can be fashioned to meet the particular needs. It is very difficult to do that with legislation. Legislation tends to be much more in the nature of one size fits all.

Mr RICH-PHILLIPS—Obviously with discretion to the Audit Office, though.

Mr SMITH—With discretion to the Audit Office. Yes, I accept that. But on here, as we have said, if we get push-back on a particular provision, firstly, by doing it contractually the firms can make their own judgment about how they deal with this and how they approach that risk, whereas with a legislative provision it is of a different nature and most firms have greater difficulty dealing with that in a risk situation or risk sense than in a contractual arrangement. Secondly, the contractual arrangement can be modified when there are good arguments. An example is, as Adrian mentioned before, some push-back. If we think that push-back is reasonable, we can modify the clause to suit the particular needs. In some cases we would agree that the push-back is reasonable; for others we would say, 'No, it's not reasonable.'

For example—this is purely hypothetical—if we had a big accounting firm saying, 'We're only providing you with a fairly routine service here. Why have you got all of these inspection requirements?' we may say, 'Yes, that's a reasonable point. We don't need them in this case,' whereas in another case if we are asking them to provide what we regard as a high-level report and we put in a detailed report where we are relying on their expertise to really give important advice, we may say, 'No, we believe these are all safeguards that we do need.' So it is about this ability to deal with the individual circumstances of each purchasing decision through a contract, rather than the much more difficult way of handling it through a legislative mechanism.

The CHAIR—It seems to be making things optional.

Mr SMITH—No, it is not making them optional. It is meeting the needs. If we go out and buy a biro, you are not going to need much. So there is a complete graduation from that—

Mr RICH-PHILLIPS—Legislation would reflect that, though. It would be to the extent necessary—

Ms HUPPERT—And then it would be discretionary. Can I raise a slightly different issue?

Mr SMITH—Yes.

Ms HUPPERT—It is, to a certain extent, about funding agreements already covered by the Audit Act, because it has certain powers, as I am sure you are aware.

Mr SMITH—Yes.

Ms HUPPERT—I am more concerned about raising issues on your standard contract engagement over $50,000. Provisions in your funding agreements often have a right for audit access; in other words, we looked at the industry grant that says, 'Companies are required to provide the Auditor-General of Victoria access.'

Mr SMITH—Yes.

Ms HUPPERT—Your standard contract agreement does not have that. It talks about 'department's representatives or persons authorised by the department', rather than a provision which allows the Auditor-General to have access. That is a different issue because, although the department has the right to access or the department has the right to review documents, that does not necessarily give the department the right to hand over those documents to a third person such as the Auditor-General. I would have thought that the confidentiality clauses in your contract, if they do not have a specific right to give the Auditor-General access, that say, 'Any document obtained under this contract is confidential except to the extent required by law,' would preclude the department from handing over those records to the Auditor-General, unless there is a specific clause, and your standard contract does not have that.

The CHAIR—It requires the department to hand over all documents.

Mr SMITH—Yes. Firstly, is that requirement there? If we have the document, we are obliged to hand it over to the Auditor-General as part of the audit, so I do not think that situation would arise. If there is a further issue, it is that the department's representative or a person authorised by the department—so if there is a particular issue, the department can authorise for the—

Ms HUPPERT—It is up to the department to choose to authorise the Auditor-General to go in.

Mr SMITH—That is up to the department. I think, more importantly, if we have the document we are obliged to hand it over anyhow.

Ms HUPPERT—The clause you have in your funding agreement makes perfect sense and that is the sort of clause that we are considering recommending for inclusion.

Mr SMITH—The main reason for the difference is that this is just a standard contract of engagement, so this would be the purchase of goods or services and, if you are engaging a significant private concern to provide those services, they are already subject to

their own audit requirements. If they are a company, they are subject to the Corporations Law, federal legislation; if they are a publicly listed company, they are subject to Stock Exchange listing requirements, including continuous disclosure. So there are a whole series of other levels that have requirements on them. The concern we have is: for fairly standard processes of buying goods and services, if you put another layer on top of that, how will these layers interact with each other?

Ms HUPPERT—In other words, you are concerned about push-back from the companies.

Mr SMITH—And how the companies will then operate; not only push-back from the companies, but this changes the environment in which the companies are providing goods and services to the government. It most likely will increase the cost of doing so, because they will have potential other layers of requirements. It most likely will increase their regulatory burden—what they would perceive as their regulatory burden of government on their operations—and we would almost certainly see a pricing differential.

The CHAIR—What exactly are you saying? They possibly will have to take out insurance against an Auditor-General examination?

Mr SMITH—Not specifically, but I think it may potentially increase their risk of inadvertently breaching some other requirement. It depends on what rights the Auditor-General has and how they interrelate with the Corporations Law and the Stock Exchange listing requirements, for example.

Mr SCOTT—How would you see there being a problem between the different requirements for accountability between the Stock Exchange or under the Corporations Act and their requirements to be responsive to the Auditor-General? How would there be a conflict? Could you explain that?

Mr SMITH—For example, the Auditor-General has his own rights to publish and he reports to parliament. Unless he provides advance notice to the company that this is happening, the company may be in jeopardy of meeting its continuous disclosure requirements.

Mr RICH-PHILLIPS—If it does not know what is in the report, it cannot disclose it, so it does not have a requirement to disclose until it is aware of it.

Mr SMITH—Yes. It depends how much they are aware of that. There are a set of issues there. If they have their own external audit, the external auditor would provide advice to the chairman of the company most likely—that is fairly typical—and the chairman is in the position to immediately advise the Stock Exchange.

Mr RICH-PHILLIPS—Yes. He has the obligation because he knows.

Mr SMITH—Because he knows. The Auditor-General has still got to publish the reports. It is to be published in an annual report, but he can make sure those requirements are met.

Mr SHAVITSKY—Do you mind if I address a presumption in a previous question about what actually sits in the agreement at the moment? As it stands, the confidentiality obligation flows from them to us—that is, we have no requirement to not give out that information. It flows the other way and we are required—

Ms HUPPERT—So you do not have mutual confidentiality provisions in your

agreements?

Mr SHAVITSKY—No, we do not, for this type of reason: we can do what we need to do when we have to. That is one aspect. Secondly, so far as the 'go in and audit' requirement is concerned, we are quite aware that the state of Victoria is in fact the contracting entity ultimately, not the department, and so the Auditor-General sits in the same position as the department does, as a representative of the state, and we can quite happily deal with the Auditor-General in the context of the powers under the agreement.

Ms HUPPERT—I am not saying that we have formed a view on this as yet, but the position that has been suggested by the Auditor-General is that they do not necessarily want to rely on the department deciding what papers and documents they choose to obtain from the contractor, and this type of clause, without the independent access for the Auditor-General, necessitates the Auditor-General relying on the department to obtain the documents that the Auditor-General would seek; in other words, it is not the Auditor-General determining what documents to see.

Mr SMITH—The point is, I think, that these clauses should be looked at as being a special case. If you are looking at managing a contract—and we are happy to provide the contracts—there are a whole range of other provisions with regard to the provision of goods and services and, as I said before, they will be the ones that we would be relying on in virtually all the circumstances to assess the quality of the performance, whether KPIs have been met, and so on. That is just part of general contract management and all those documents would be available in the department and hence available to the Auditor-General. We believe they are the ones from which you would make a better assessment about the contract and about the performance under the contract. If there are any issues there, it is really an issue about contract management, rather than about these access provisions. So, while we say these access provisions are here for good reason, the vast majority of our work—in fact virtually all of our work—in doing contract management is on the other provisions of the contracts.

Ms HUPPERT—I would expect that in any properly managed contract that would be the case: that these are a fallback position.

Mr SMITH—Yes, and the Auditor-General has full access to those documents which the department has.

The CHAIR—But what you are saying is that it is going to be difficult for him to have access directly to the company?

Mr SMITH—No, he would have access to the documents the company has provided.

The CHAIR—Yes. I am taking it one step further. What you say in these funding agreements is that the council shall, if required, provide the Auditor-General with access to accounting records and documentation.

Mr SMITH—Yes.

The CHAIR—So you are saying that is physical access as well as access to the records that you hold?

Mr SHAVITSKY—Yes, and in the funding agreements the Auditor-General has that access, and he has that under legislation anyhow.

Ms HUPPERT—He does have it under legislation. The question is why—

The CHAIR—He has access to the records that you hold.

Mr SHAVITSKY—Both.

Ms HUPPERT—Yes, there is a provision.

Mr SMITH—Under funding agreements he has both.

The CHAIR—And under funding agreements he has access to both?

Ms HUPPERT—Yes.

Mr SHAVITSKY—And we were quite keen to reflect that in our agreement so that they were aware of it. So it not only creates a legislative access; it is coupled with the contractual arrangements.

Mr SMITH—And in some sense it's a reminder of the legislative requirement: when the contract ends, where the funding has got to be provided.

Ms HUPPERT—Yes. That provision that you have in your contracts in relation to funding agreements is clearly reflecting what the current state is at law. We are trying to see why the situation should necessarily be different as a contract for the provisions of goods and services, carrying out works, that type of thing, as opposed to where the value is possibly higher. I know some funding agreements—R&D grants and that type of thing—are necessarily quite valuable contracts. The argument the Auditor-General has put is that that right should be extended to contracts for goods and services, not merely funding. You have raised a number of issues, saying why it should not be extended, but mostly on the basis that it is not necessary rather than that there is any particular intrinsic philosophical reason why it should not be extended. Your arguments—and forgive me if I am not interpreting them correctly—appear to be on the basis, 'Well, it's just not necessary. We manage contracts well; therefore it's not required,' whereas we have not actually seen an argument why it should not be. In other words, is there a reason why, if that is the case, there should be any difficulty with extending it?

Mr SMITH—It will partly depend on the size of the contract. We are concerned that, if we extend this as a general provision, it is going to impact on the department's ability to efficiently and effectively conduct business with the private sector. When two people are dealing in a commercial relationship, it is not usual for one party to have an inspection right on the other party. The contract will set out performance conditions to provide those goods or services and it is dealt with in a contractual sense that way. If we are buying stationery—or even slightly more expensive operations, but contracts of modest size—then this is a very strong provision that is going to increase the regulatory burden potentially on those companies and must then be reflected in the price the government is paying for those goods and services.

If you are saying there are also some very large contracts where it may be more appropriate to do that, then that I think is a separate issue. I have been focusing here more on what I would call the standard day-to-day, week-to-week contractual arrangements. The one-off contractual arrangements, while we use the standard forms, tend to be modified to meet the particular circumstances, because they are large one-off contracts. That is something to be just looked at at this stage and—

Ms HUPPERT—Are there, for example, large one-off contracts that would have a provision, as your funding agreements do, which would specifically provide for access to the Auditor-General?

Mr SMITH—The ones we would tend to deal with in that case tend to be more in the nature of project delivery.

Ms HUPPERT—Yes, that is particularly the type of contract it would be.

Mr SHAVITSKY—It depends on the nature of the project delivery that we are talking about. There are different project delivery models.

Mr SMITH—But even on our standard design and construct contract—

Mr SHAVITSKY—As I say, they are actually the DOT style forms that are in use at the moment.

Mr SMITH—Yes. We are using a range of other contracts there. We will come back to you and advise you. I am not able to advise exactly what the access rights are there.

Ms HUPPERT—I would be interested to hear. Thank you.

Mr SHAVITSKY—I can supplement that commentary. There is a distinction that we encounter in negotiating on a contractor agreement and our funding agreement. We almost find no resistance with the funding agreement scenario. Even though we have more extensive audit rights, they accept the proposition that if it is a government grant and you can only treat with government to get money in that kind of a way—

The CHAIR—If you sign the agreement.

Mr SHAVITSKY—They sign the agreement. That is the position and we do not encounter a problem. We have, however, even with our softer provisions, as I have indicated, encountered some resistance in a commercial context, saying, 'Why should we engage with you and give you access to our whole kit and caboodle, all of our books, for a very quarantined bit of service that we're providing to you like we would deal with anybody? Why do you need all of this?'

Mr SMITH—The important point Adrian just made is that private sector firms have an option of not dealing with government in those cases. If we put too many requirements on them, over and above what they would normally do in the rest of their business, then they may exercise that option.

Ms HUPPERT—They have a choice not to treat with the department.

Mr SMITH—And then we have a more limited range of people we can buy these goods and services from, which adversely affects the efficiency of government.

The CHAIR—If you got a hypothetical case, which is always difficult to deal with, of someone building a pipeline—and there are a number of pipelines which are built, carrying water, gas or whatever—you obviously enter into a contract and you pay a price for a certain outcome. The Auditor-General then audits the construction of a particular pipeline. What would you see in that case—or, indeed, a solar power station?

Mr SMITH—In those hypothetical cases, which are typical construction contracts, we would receive at least monthly reports. They would be certified by the contractor—as Adrian has pointed out, at director level if it is a significant size, and mostly independently of the director. The work done is assessed by a superintendent or a site inspector employed by the government. We would then make payments on a 'work done' basis. It is that detailed

reporting mechanism which will give us the monitoring of the project.

The CHAIR—How would you expect the Auditor-General to audit that and what would you have in the contract?

Mr SMITH—He would have full access to all of those reports. As I said, I will come back to you on what additional provisions, if any, there are. He would have access to all those reports and all the reports that are prepared within the government in monitoring that project.

The CHAIR—But then would he have access to the contractor's premises?

Mr SMITH—As I said before, I will come back to you on that.

The CHAIR—Yes—which he is particularly raising, and then we can go to the PPPs, if you like.

Mr SMITH—The issue you are talking now, though, is: what premises? The contractor's premises are mostly separate to the premises on which the work is being done. The contractor will have a head office and various other things. The work is being done usually—not always but usually—on government land. He would have some access rights via the government ownership of the land.

Mr SHAVITSKY—Perhaps I should distinguish the construction style contracts from the grant agreements in terms of the audit.

The CHAIR—Yes, I understand that. That is why I used a pipeline.

Mr SMITH—That is right, yes.

The CHAIR—A commercial agreement.

Mr SMITH—We are talking a construction type contract.

The CHAIR—Yes. Going to PPP, you have got something further than that. It is, of course, not just a construction one; it may well be the provision of a service over a long time. And, of course, there can be highly complex commercial relationships.

Mr RICH-PHILLIPS—That is probably a better example of where this becomes an issue, particularly when it is a long-term service delivery obligation.

The CHAIR—Do you want to comment on that?

Mr SMITH—Our initial response would be that the department would be requiring significant information—monthly reports on an ongoing basis—to ensure not only delivery during the construction phase but also the provision of those services to the appropriate standard—to the performance indicators and all the other requirements. We would be looking for detailed monthly reports from the concessionaire on those.

We would see that as a contract management issue and that information, again in the hands of the department, is available to the Auditor-General. If the Auditor-General is of the view that there is a deficiency in contract management, he can make those findings. But we would see that it is very important for the relevant department to be very active in the contract management for the full life of the concession to ensure that the services are being delivered to the agreed standards.

Mr BARR—That may include regular financial statements and audited statements.

Mr SMITH—It would most certainly involve forecast outlays in advance—one year in detail; maybe two, even more years in outline—and on a rolling basis, and measured against those on a regular basis, a quarterly, half-yearly or annual basis as relevant.

The CHAIR—Going back to our pipeline example where, say, it is not just the construction but also the maintenance of the pipeline and, while you have maintenance supervision arrangements in place, the Auditor-General might wish to inquire into whether the contract is maintaining that maintenance so that at the end of the contract the particular piece of work—in this case it might be a pipeline; it might even be a road—will be handed back to the state at a certain standard, specification.

Mr SMITH—Yes.

The CHAIR—If some doubts were cast on that, he could probably only do that by cross-checking the records, and it might be quite an intrusive audit in that case because it may well go to the viability of the company because they are not putting enough money into maintenance.

Mr SMITH—As Rob has just indicated, we would see that you would have forward estimates of maintenance, certainly on an annual basis—if not monthly or quarterly— and you would be measuring the company against the performance, against their accounts, which would be, as indicated before, certified by the directors and audited by an independent auditor. So we believe that there are a whole range of safeguards there to say whether the money is being spent or not. If it is not being spent, it is a matter for contract management to address why. Sometimes their sums may not be spent because they have found a more efficient way of delivering the maintenance so the standard is there. But you would certainly want a detailed explanation of why the forecasts were not being met and that would be available for the Auditor-General as a matter of course from the contract management of the department.

The CHAIR—So you think the act is sufficient at the moment?

Mr SMITH—I think it is. We are putting it in the sense that these are issues to be looked at, if you wish to change the act. I do not think we have a view on whether the act should be changed or not; we are putting up a range of issues, particularly from our involvement with the private sector and our relationship with the private sector, to say that we believe that these are some of the things that you would be likely to find the private sector saying if you consulted with them directly.

Ms MARTIN—In the submission from the department, there are a number of points where we have agreed that points in clarification might be helpful and, where questions have been asked, we have noted that we concur or agree that perhaps it might be helpful and, for the sake of clarity in some matters—for example, consolidation of the Auditor-General's powers in one spot, those sorts of things—there are points where there perhaps might be some benefit in tidying up a few bits.

Mr RICH-PHILLIPS—Your submission does reflect DIIRD's views only? It is not a consolidated—

Mr SMITH—Yes. It reflects DIIRD's views only.

The CHAIR—We should get our secretary to cross-check what the Treasury guidelines are and maybe even check what a range of departments do in response to those

guidelines. Even in the examples you give, there are some differences in the way you tend to approach different ones.

Mr SMITH—Yes.

The CHAIR—We have said before on certain elements, particularly in regard to tendering, that there should be some consistency across government, not just between departments but also by agencies, which do not always follow or seem to be required to follow guidelines, particularly when it comes to tendering and in respect to probity arrangements in tendering. That is something which we have looked at in the past. So, rightly or wrongly, this committee does have a view on consistency and the application of such consistency across the board. I know, Adrian, that gives you a problem because you have to try and negotiate these contracts but in many ways that might actually be a help.

Mr SHAVITSKY—Yes.

Mr SMITH—We believe there would be more consistency because Treasury and the Victorian Government Purchasing Board—it may have changed its name now—set out guidelines and they are followed by departments. Some of the other broader issues are beyond my scope to comment on, but I think some of them may be covered under the proposed Public Finance and Accountability Bill.

The CHAIR—Yes.

Mr BARR—We operate an accredited purchasing unit—APU—which looks at the probity of all transactions over $100,000, consistent with VGPB guidelines, so I think all departments are broadly consistent in that respect.

The CHAIR—Thank you for that interesting discussion. That concludes consideration of the evidence provided by the Department of Innovation, Industry and Regional Development. I thank Mr Smith, Mr Barr, Ms Martin, Mr Shavitsky and Mr Kirtley for their attendance today. Where questions are taken on notice, the committee will follow up with you in writing at a later date and request that any written responses to those matters and any information be provided within 30 days. Thank you very much.

Witnesses withdrew.

Hearing suspended.