

VERIFIED VERSION

PUBLIC ACCOUNTS AND ESTIMATES COMMITTEE

Inquiry into Effective Decision Making for the Successful Delivery of Significant Infrastructure Projects

Melbourne — 20 March 2012

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Witnesses

Mr D. Pearson, Auditor-General,

Mr R. Winn, Sector Director, Transport, Performance Audit, and

Mr P. O'Connor, Sector Director, Technology Review and Annual Plan, Performance Audit, Victorian Auditor-General's Office.

**Necessary corrections to be notified to
executive officer of committee**

The CHAIR — I declare open the Public Accounts and Estimates Committee hearing on the inquiry into effective decision making for the successful delivery of significant infrastructure projects. On behalf of the committee I welcome from the Victorian Auditor-General's Office Mr Des Pearson, the Auditor-General; Mr Ray Winn, sector director, transport, performance audit; and Mr Paul O'Connor, sector director, technology review and annual plan, performance audit. Members of Parliament, departmental officers, members of the public and the media are also welcome.

In accordance with the guidelines for public hearings, I remind members of the public gallery that they cannot participate in any way in the committee's proceedings. Only officers of the PAEC secretariat are to approach PAEC members. Departmental officers, as requested by the Auditor-General, can approach the table during the hearing to provide information to the Auditor-General by leave of myself as Chair. Written communication to witnesses can only be provided via officers of the PAEC secretariat. Members of the media are also requested to observe the guidelines for filming or recording proceedings in the Legislative Council committee room, and no more than two TV cameras are allowed at any one time in the allocated spaces. I remind TV camera operators to remain focused only on the person speaking and that panning of the public gallery, committee members and witnesses is strictly prohibited. I am also pleased to announce that these hearings are being audiocast live on the Parliament's website.

All evidence taken by this committee is taken under the provisions of the Parliamentary Committees Act 2003, attracts parliamentary privilege and is protected from judicial review; however, any comments made outside the precincts of the hearing are not protected by parliamentary privilege. This committee has determined that there is no need for evidence to be sworn; however, witnesses are reminded that all questions must be answered in full and with accuracy and truthfulness. Any persons found to be giving false or misleading evidence may be in contempt of Parliament and subject to penalty. All evidence given today is being recorded. Witnesses will be provided with proof versions of transcripts to be verified and returned within two working days of this hearing. Verified transcripts will be placed on the committee's website within 14 days.

Following a presentation by the Auditor-General committee members will ask questions relating to the inquiry. Generally the procedure followed will be that relating to questions in the Legislative Assembly. I ask that all mobile telephones be turned off. I now call on the Auditor-General to give a brief presentation of no more than 4 minutes if desired.

Mr PEARSON — I would like to say a few comments just to round out our 9 November submission. If I just relate to our written submission, it basically drew on our audit work and raised four contextual issues I think need to be kept front of mind, which are the scale of these projects, the inherent risk involved in them, the delivery mechanisms that are used and the quality of governance applied. We drew on seven recurring audit themes, and I can probably summarise those into two areas that at a very high level are related to more purposeful management and clearer delineation of responsibilities and accountabilities — the permeating themes in those.

Thinking about today's hearing I went into a bit of a reflective mode and put the audit prism over the terms of reference for this inquiry. That has led me to reflect that the system is doing lots of things right — the various processes, the people working conscientiously and that we are using rational models — but at the end of the day I think why we are having this inquiry is that there is a bit of debate as to whether we are getting the right outcomes. So we are doing a lot of things right, but are we doing the right things? That is probably the real challenge going forward in this complex area. We are trying to divine through a complex mix of on the one hand managing expectations of the stakeholder group and on the other hand more purposefully managing in a very large and complex situation.

In that respect, when I reflected and thought about it, there is one threshold thing I would say. You might prove me wrong, but the external audit is probably the only external review function happening. That made me reflect that as we do our audits we audit a selection of projects, and I suppose my challenge is that I am not sure that in the executive arm of government there is a hard-nosed systemic review of projects at a system level. Having said that, it occurred to me that there are probably two areas where more attention might be warranted, and that is in the planning or the pre stage and in the post-evaluation stage.

On planning, there are a few questions that come to mind when you look at it from an external perspective. Are we jumping to solutions instead of properly assessing needs? In a sense, we are working from an idea or

perceived solution and then immediately operationalising that rather than the needs. Are we retrofitting a project to an announcement or an idea rather than doing a proper options analysis and running the discipline over it of ‘What is the outcome we want?’ and then starting from that and working back through the various ways of getting it rather than suggesting an obvious way to achieve the outcome and limiting our options?

The third area in planning is: do we in the public sector still have or is there a skills gap in the ability to develop business cases and undertake options analysis? We have been through probably a generation of outsourcing and trimming and slimming, and it really raises the question in my mind, ‘Have we run down the intellectual capital?’.

If I then jump to the evaluation stage, probably the key question that comes to my mind as an auditor is: do we have an adequate feedback loop operating? That brings in subsidiary questions: are we serious enough about effecting and reporting on benefits realisation, because all these major projects are undertaken and performed to achieve an outcome, but there is probably at least a perception and a risk from an auditor’s perspective that, having done the hard work, we do not stay around, do the paperwork and check that we got the result we were seeking. Similarly, are projects, to the extent they are being reviewed and evaluated, being individually reviewed ab initio, so that they are in isolation and are we not building up the cumulative wisdom via systemic-level review and cross-fertilising of the learnings. We are in a complex area. It will never be perfect, and there will always be lessons to be learnt, but the challenge here is for the system not to repeat lessons.

Finally, I thought some contextual considerations were relevant, and again I pose a few questions there. Is adequate benchmarking and baseline data available to underpin the various projects we embark on? The next one is: are we punishing ourselves for cost overruns and not adequately managing expectations? There I relate — and we refer in our written submission — to the research by Professor Bent Flyvbjerg in 2009. Just to refresh your memory, he researched worldwide project outcomes and found for construction project budgets between 10 million and 150 million euros, the norm was a 50 per cent overrun and in IT projects it was up to 500 per cent on the target projects. In quoting that I am not saying it is all right to overrun, but it is a recognition that we are not alone in experiencing this problem. In my reading of his research, there are lessons to be learnt there of key lead indicators and issues to be addressed up-front in what I would call purposeful management.

The final issue, which I touched on with planning, is: have we reached the stage in the public sector where there is a skill-set deficit? As an auditor, I have not done a specific audit on that, but it raises the issue — and I have already mentioned a generation or more of outsourcing and running slim and trim — on which I will probably close my opening comments: are we in the public sector capable of being an informed infrastructure purchaser?

The CHAIR — Thank you very much, Mr Pearson. I am very keen to pursue some aspects of your oral evidence but particularly of your written submission. In that context I pick up the issue of cost overruns, which you have just touched on. In the context of the stated \$2 billion of presently identified cost overruns on projects, the obvious question is how can the Victorian public be assured it is getting value for money? In that context in particular, I just want to refer to your submission were you referred to DTF’s potential ‘role conflict’ in having different responsibilities in terms of it being a participant in the development of projects and having the oversight function. Can you elaborate on that conflict issue, and then lead into the broader issue of the core skills and competencies that should therefore be requisite in DTF to be able to manage its function and oversight the devolved agency project management.

Mr PEARSON — I would ask Mr O’Connor to introduce that.

Mr O’CONNOR — The reason why we placed this paragraph in our submission was that we have been saying, particularly in our reviews of major infrastructure such as alliances, public-private partnerships or major ICT projects, that the Department of Treasury and Finance has really morphed into having two key roles. One is to be the secretariat for the executive government’s budget-making process in terms of providing objective advice to government in terms of what projects should be approved based on their analysis; but very clearly they are also heavily involved in project initiation and are sometimes even party to key decision making within those projects. It is very usual for a member of Treasury to be on a procurement panel that is making key decisions for a public-private partnership and even for Treasury actually to run the process of doing a business case on behalf of an agency. It does tend to blur, where that particular officer in Treasury who is supposedly working for a project, what type of capacity that agency then has to give objective advice to cabinet about where that project is at in its life cycle?

The second part is not so much in the scope of this inquiry but particularly for IT projects — and the Ombudsman picked it up in his recent report — Treasury officers sit on project boards, but they do not see themselves as being either delegates or representatives of the Treasury in that role. I think the Ombudsman says quite clearly in his report that one Treasury officer interviewed could not actually explain what his role was on a board that was responsible for a project worth many hundreds of millions of dollars. That is the basis of our words in that submission. We are not saying that Treasury is not performing its correct roles, but in the office's view those roles are becoming blurred and potentially conflicted, as we have described here. This is perhaps similar to some of the other reports we have made previously about, say, the conflict between the role of a probity adviser and a probity auditor — trying to actually separate those two roles and make it very clear where the border is.

The CHAIR — Do you want to finish on that?

Mr PEARSON — I was just going to, in an overview, address the skill-set issue. I will say in the broad before I ask Mr Winn to go into detail that that is one where I observe in my role that too often agencies are, in my view, overly reliant on external advice, and they are not exercising due diligence in respect of the quality of that advice before they apply it. Because it has got the cover of a big firm, or something like that, they take it as gospel and as an authority.

In recent times I have been as rude as to draw accountable officers' attention to the disclaimer paragraph which is invariably on page 1 or 2 of the report that limits it, and it is amazing how often at all levels that is a real enlightenment to the public service administrator. That is where I come at it from.

Mr WINN — So from our audits we found gaps, inconsistencies and sometimes errors in business cases that had not been discovered through the review, either by the sponsoring department or the Department of Treasury and Finance, and that for us is a deficiency on the departmental side.

The CHAIR — That intimates that you have the view or your observation is that the skill set is not requisite within DTF to be able to do that analysis. Is that what you are implying?

Mr PEARSON — I have difficulty in saying outright that it does not exist or it is a deficit, but we do have recurring findings where, as I typify it, you have a business case, it has a cover, it is headed up, you open it and the index looks all right, but once you start reading the paragraphs it is too much towards a cut and paste or a filling in of a form rather than substantiveness. Mr Winn has mentioned examples where even the base data has not been there. So I am not sure whether it is solely the skill set or because we are a large and complex organisation and people are taking a narrow interpretation of their responsibility and not exercising what I call that due diligence or the ownership in respect of the task of taking the extra step to understand the advice they have been given, distilling it and reaching a conclusion as to whether they can reliably use it.

If we go back a step from that, they are probably being a bit broad in their terms of reference when they seek advice and at the other end they are not challenging the advice.

The CHAIR — That is an interesting observation, because it also leads to some evidence that the secretary of the DTF gave earlier today in relation to the lessons that it would not share with Ms Hennessy by not giving her access to the intranet password. I think the issue here is your observation about a requisite need for the executive to undertake a post-project review.

So in top and tailing this conversation you were saying that on the way into a project there is not enough detailed scrutiny of the business case by DTF and you are also inferring that there is insufficient executive analysis post-project, and that in effect conflicts with evidence that was given here earlier today.

Mr PEARSON — Again, our audit findings give yet another illustration of this in a broader context. Agencies are charged with accumulating or assembling a central report. We are finding in recurring findings that they are not providing guidance to the agencies about the quality of data that they receive. We know they receive it; they are just aggregating it up. My expectation is that there will be a higher level engagement from a responsible public administrator. It is not a mechanical task; it is an engaged-in task. You should understand the purpose of the report, provide guidance to be reasonably sure you are going to get the right sort of information and then check the information that you receive to ensure it meets your standard. That is a recurring theme.

Again I come back to this: it is a complex thing. I think if we examine it, we might find that in theory people have the qualifications, but it might be in the culture and the application of it. I think that is a fact of large bureaucracies — people tend to take the minimalist view, do what they think and define it so that they succeed. Again, as the auditor, I am looking for a tight system of robust controls, and, as I said in my opening statement, it is not for want of trying. There are a lot of rational models being used, a lot of appropriate processes, but what seems to be missing is the purposeful bringing together and the exercising of judgement and discretion on a day-to-day basis to make sure we are progressing towards achieving the outcome we sought.

Mr PAKULA — Auditor, you have said before and you have noted in your submission the fact that the audit mandate cannot follow the dollars into what you described as the private sector partnership sector, which I assume means not just PPPs but alliance partners et cetera. I think it would be useful for the committee if you were just to take us through why you think it is important that the auditor has that power, how you say it would work and whether you think private sector partners of government, whether they be, as I say, in an alliance or a PPP, should in any way be concerned about an auditor having that sort of power and whether you think it would act as a disincentive for private partners to engage with government in major projects.

Mr PEARSON — The principle approach I take is that public sector accountability is fundamentally based on using taxpayers dollars in the public interest. Basically the resources are extracted from the community by force — there is nothing voluntary about paying your tax and charges — and the overriding obligation is to apply those resources for the common good of the whole community on an equitable basis.

I think we are at a bit of a crossroads. Traditionally in the past the public sector has done what the private sector is either unable or unwilling to do, so we have been a monopoly provider and it has all been in-house. My contention is the current audit legislation, as it still stands in Victoria, has been drafted in that context where essentially everything was done within the sector and there are strong powers in there of access and being able to examine people under oath — though we do it rarely, it is a reserved power — but by the nature of the public sector it is a monopoly provider or a rationer of limited resources to excess demand. So it is not a logical marketplace; you do not have the inbuilt checks and balances. The quid pro quo for that is sometimes you need to directly interview and assess people to form your judgement as to whether it is operating efficiently and effectively.

What we have done, probably over the last 50 years but at an increasing rate over the last 20, is engage more and more with the private sector to participate in the delivery of public programs. As an auditor my contention is that just because the mode of program delivery has changed, that should not change the public sector accountability principles, that the Parliament is entitled to an independent auditor who can form a view and report that opinion to Parliament and there is no executive authority, but Parliament is in a better position to consider and debate the issues.

What we have now is that at the first stage, I suppose, of buying in — buying supplies as simple as stationery and things like that — it really does not come into it. But when you get into interaction in the delivery of programs, such as in public transport, with outsourced delivery of the train, tram and bus services, with PPPs in terms of a 40-year contract for delivery of outcomes — alliance contracts, as you have said — so basically any commercial contract for the delivery of services, from time to time I would argue that the auditor, to form an opinion about the efficiency and effectiveness of the delivery of the service, would need access to information and assets of the state in the hands of the private provider, because without that access it is at one level constrained by the quality of management and foresight of the program manager. The established accountability principles are that we have already covered that by providing the auditor with full and free access to everything, such as cabinet records and things like that, and this is the equivalent.

If I jump to the other end, I find it difficult to see how an argument can be sustained by private sector providers or by public sector advisers that it would be a disincentive for the private sector to treat with the government. I think it is a parallel to the debate in the early 90s about commercial-in-confidence clauses in contracts and giving the auditor access to those contracts. I suppose in an extreme sense there might be a very slight marginal cost to a particular contract that we did an audit on, but it would be an exception and, to me, it would be extremely marginal. I would not see it as a disincentive. In fact the trend around the country is about half the jurisdictions have amended their legislation to provide universal access to partners in service provision, and there has been no deleterious effect in those jurisdictions from the private sector wanting to treat with the public sector.

I am not an expert in the area, but I think the private sector have got goods to sell. At worst they will price the risk in, but my argument is the risk would be of negligible cost. You would never be able to identify it in the cost, because you would know from the other side of the committee's operations when you look at our budget, the area where it would be most likely to come into play would be performance audits. We are lucky to do 28 to 30 performance audits a year.

I have got two points in raising that. It is very much a reserve issue, but nevertheless it is an important aspect that where the public sector records or management are deficient you need to go for the third-party evidence or corroboration to form your conclusion. It is more likely to be interviews and discussion. I have to say it is one of the things we are asking for legislatively. In the main we are finding the private sector already cooperates. When we approach them and whatever the biggest worry for us is that if the audit is not going well and there are likely to be particularly adverse findings, I probably worry more about the public sector program manager leaning on their commercial partner and drawing their attention that there is not an obligation.

Mr PAKULA — They are not obliged to talk to you.

Mr PEARSON — And drawing on that primary contractual relationship.

Mr PAKULA — To be clear, when you are talking about the private partner, you are not talking about traipsing over their whole operation. It is just in regard to its interaction with the government on a particular project that you would seek information?

Mr PEARSON — Yes; certainly not auditing the books of the private provider. It is the equivalent of us talking to program managers in a department. We would want to talk at that level. I could not rule it out, but we would not be going into their central ledger in terms of looking at their underlying profitability. If we did, it would be about the classification of expenses or something like that. Paul might have a couple of examples.

Mr O'CONNOR — To give some specific examples where we have come up against this problem, there have been two audits that I have personally been involved in. One was a review of Southern Cross station. The performance data is held by the private entity, and in order for us to gain assurance over the collection of that data — because it is all self-reporting; it is all collected by the private entity — we had to review the records held by the Southern Cross Station Authority, because we did not have power to review the data held by the private entity. Likewise, as the signatory on the public private partnership, the only rights the state had was spot checking of that source data to make sure that, for example, performance indicators, which are linked to payments, are correct.

The second example would be where we did the prisoner accommodation audit. That was a complex situation, because there were some pre-2000 contracts and post-2000 contracts. We reviewed the whole gamut of those. What we found is that particularly, say, with a help desk where there is a broken window or some type of physical alarm system has gone down, which is quite serious but also occurs quite often, we could not review directly with our current audit mandate the operations of that help desk and how incidents were classified by the operators. What we were able to do was to use the clauses in that particular contract to have access and visit that facility, but I think, as the Auditor-General has said, we should not have to rely on one particular contract to give us access powers. Clearly that is public money being spent for a public purpose, and that is where I think the issue is around 'follow the money'. It is giving the auditors the opportunity to make that level of verification with that source data.

Mr MORRIS — May I say, before I get to the question, on the issue of performance audits, we have heard evidence in other jurisdictions where the number of performance audits is something like one-sixth of the number that you are conducting in Victoria, so while there is always room for more to be done, we are probably reasonably well served in comparison with other jurisdictions.

Mr Pearson, you raised a number of issues which, if considered in isolation, are pretty damning: a narrow interpretation of responsibility; a lack of adequate management in some cases; in terms of the questions that you raised, to start with issues of jumping to solutions and then effectively retrofitting them; and particularly the skills gap. I do not think there is a point in there that I would not agree with, but that is really, as far as I am concerned, based on anecdotal evidence and the information that we have received from you via your reports in specific cases over the years.

The particular area of interest for me is the requisite competencies and skills, and whether they in fact exist. I was wondering whether you were able to furnish comment, either as part of this hearing today or perhaps in written form later on, on the information that has been provided to the committee on term of reference (a) by DTF and particularly by the main constructing departments and agencies. I would certainly be very interested in your views on their views.

Mr PEARSON — I will check, but there is something to add. As I think I have already said, if we did an audit of the skills and competencies — the technical or theoretical skills — the qualifications are probably there. My question is about the application and use of them. What concerns me, as the auditor, in the sort of examples we have used in our submission and others I have used in my comments is they are almost universal findings in our audits. The challenge is reconciling that with our system, by standards, is pretty good, but what worries an auditor is that it is good because of honest people and goodwill, whereas I think we are entitled to a higher level of accountability. It is the same if we go back to a financial management system, of simple things like two people opening the mail in case there is cash in it. Some of those things you just need to do to establish the framework and, as I tried to say in my opening comments, there is an elusive element that there are a lot of right things being done but I am not sure that things are being done right. That is where it comes down to the culture and the overlay.

If I just go a bit broader, in recent audits we have done with the state purchasing contracts, where the state has negotiated contracts in view of the savings, and the leakage rate from those, if I was a financial controller, I would be very worried, yet the system is not on the front foot in terms of monitoring compliance and providing the feedback for it. My term is that we are probably dealing with a pendulum that has probably gone a bit too far into the devolution mode without an adequate check and balance. In a sense, you can go into the devolve mode but you need to sharpen your monitoring and work out what are the real risks and respond on those, yet too often we find that either the monitoring information is not collected, or if it is collected, it is not analysed. Those are the sort of things that contribute to the situation we are examining.

Mr MORRIS — That is useful, but can I repeat, if I may: would you be prepared to review the submissions that we have had from DTF and the central constructing agencies and provide further advice to the committee? I would certainly be interested in seeing how, in your view, the submissions of the agencies match with your experience in terms of the actual audit.

Mr PEARSON — We will do an analysis of that.

Mr MORRIS — That would be good.

Ms HENNESSY — I am very interested in Dr Flyvbjerg's research, which you have referenced in your submission. It is quite frightening when you read that this is not just a Victorian phenomena, it is an international phenomena in terms of public sectors' inability to deliver projects on budget and on time. I am particularly interested in what your views are of some of the propositions that have been adopted in other jurisdictions, specifically having peer-reviewed business cases or costings of projects, like they do in the UK with the National Audit Office. I also note Dr Flyvbjerg's suggestion that there should be strong penalties, including criminal sanctions perhaps, for those who underforecast the cost of projects. And finally, I would be interested in your general comments around cultural change. What is it? Is it optimism bias? Is it that we have built the wrong political incentives and therefore that leads to the wrong bureaucratic incentives? What, culturally, do you think, would signify the greatest circuit break and give us more legitimate grounds for what you describe as purposeful management?

Mr PEARSON — I will just lead in with a broad comment on that last issue raised because I think that is getting to the core. We are in a society that has moved a long way in a short time. I think there are some real issues because when we deal in audits often when we are talking to departmental staff they are saying, 'The government announced' and they are using that as what I call a get-out-of-jail card not to provide frank and fearless advice and saying that, 'While that has been announced, be aware that there are these other alternatives that could or should have been considered'.

We are in a new era. The public sector in my career has gone from permanent heads that probably were too permanent and non-responsive to governments of the day to — some would argue — the pendulum has gone

the other way. We have a real cultural thing there, and that may be an issue that this inquiry may want to touch on.

It is basically the balance — a redefinition of the rights of a minister, because governments are elected to govern and take decisions. But in relation to reconciling that with what I see as the obligations of a public sector adviser, the minister is clearly entitled to make a direction and decision. But I have a reservation — I have not done an audit — that public servants are not putting to ministers the consequences of the implications of an announcement. My fear is that ministers might not have been told what they should have been told on the way through.

I have a suspicion that bureaucrats use the announcement to avoid having to do the hard work. So there is a bias towards delivering what I was told to do and taking that narrow interpretation. But Paul might be best to answer as far as on the collaborative — —

Mr O'CONNOR — I have not given Ray a chance yet.

Mr WINN — That is all right.

Mr O'CONNOR — I think Ray has some views in terms of particular options analysis early on in projects. To pick up on what the Auditor-General said, I think before we go to what Professor Flyvbjerg says, I think we have to look at how we do things in Victoria at the moment. The reality is that a lot of business cases are retrofitted to ministerial announcements. As soon as people start talking openly about that, then some of these cost overruns or bad project issues may at least be given more attention. I think that is sort of a little bit unutterable, but I think it has been a reality over many years, and not just in Victoria of course.

The second thing is that if you look at all the processes that, say, the Department of Treasury and Finance has put in place, they will get totally negated if you salt the sample nice and early — that is, put that sprinkle of gold dust in your core. You have actually said, 'This project is a goer, because we say so', rather than going through the rigour of testing the data and the needs analysis — that is, all of the viable options and not just the options you want — and then testing it through a peer review process that you have intimated.

We already have a peer review process; it is called Gateway. But the problem is hardly any projects go through gate 1, which is strategic alignment. Fewer go through the options analysis business gate. I think that is actually a problem— we have built the system to allow us to have this impartial, expensive advice, but we only use the bits we want so we get a tick off just before we go to tender. All we are doing is saying, 'Yes, we have constructed our tender documents appropriately', but we are not actually asking ourselves, 'Are we doing the right project?' or, 'Is this the right option to meet that particular need?'

I think that is a cultural issue, because people want to get projects done. They have been announced. There is a lot of political capital that is invested in those announcements. It is very difficult to unannounce a project. That hardly ever happens.

Ms HENNESSY — You can understand that.

Mr O'CONNOR — Budget processes drive and sometimes speed up the orderly move through from concept to business case. I think these are the realities, but if you look at what Professor Flyvbjerg says, he comes to two hypotheses. He says it is either deception or delusion — that is what he boils it down to.

Even though I am a jaundiced auditor, I actually try to think that is a glass half full. It is mainly full actually. I do not see overt criminal deception occurring in the public sector. I do not believe that is a driver. I think though there is a fair degree of delusion. The delusion is driven by a lack of knowledge and a lack of research. If we look at what his article proposes, we see he says you can clean up most of this delusion through a very simple process called 'reference class forecasting', where you basically look at your projects and say, 'What am I doing? Where has it been done before? How long did it take them? How much did it cost? What are my estimates saying?'. I would say that hardly ever occurs in major projects in Victoria. If it does occur, it is buried away in briefings that are never given any ventilation.

But to publicly put these reference class forecasts up — or reference projects — that actually start to say, 'Well, we have been saying it is a billion dollars, but everywhere else in the world it has cost 3' or, 'We are saying it is

\$3 billion but in Spain they can do it for 1 — why is it 3 billion in Victoria and 1 billion in Madrid?'. Perhaps central agencies could take a stronger role in actually putting a lot more of that work on the public record.

I will use an example of the post-signing of the public-private partnerships when the project summary was published. It really was quite illuminating for the Department of Treasury and Finance to actually table through the Minister for Finance a statement to Parliament about the costs, benefits and contractual obligations of a 25-year or 30-year PPP project. I think if we perhaps did that for every project over 50 million, we would start to see a real focus on the rigour of what advice you are providing to the Parliament and citizenry. But of course, you know, obviously — —

Ms HENNESSY — That would be open to public contest then?

Mr O'CONNOR — He does talk about making a lot of these considerations of major projects. Put them in a public domain.

Mr O'BRIEN — Prior to the decision being made.

Mr O'CONNOR — It is prior to the decision being made, which then becomes a political question for the government of the day as to how it wants to manage a process such as that, but he is saying that is where you clean up a lot of these overestimations and optimism bias.

The CHAIR — That is a very fulsome response, but it threw out something I think the committee needs to understand better. You said that few projects go through the Gateway process.

Mr O'CONNOR — Through gate 1 and 2 and the final gate as well, which is the evaluation gate.

Ms HENNESSY — How many gates do we have?

The CHAIR — I should know, because the former Treasurer used to talk about it endlessly.

Mr O'CONNOR — Six.

Mr WINN — Can I respond to the last part of your question?

Ms HENNESSY — Yes.

Mr WINN — I guess it is along the cultural side. We have observed mistakes or assumptions — unreasonable assumptions in business cases — which have survived through a review process. They have survived all the way through every level of government to implementation. For example, there is the notion that you can spend \$1 billion on an urban road and assume that introducing that massive increase in capacity, because of expanding a road, will have no impact on what traffic would have been otherwise — so it is the induced traffic argument. You made that assumption, it is in the business case, it has gone through every stage of review. To us as auditors that is a real concern. It has not just gone through a department; they have not really flagged this as an issue.

That could not happen in the UK, it could not happen in New Zealand. With every project over £5 million in the UK you must assume that an urban project will induce traffic and you must say, 'How are you going to deal with it?' or go through processes to prove that it is not an issue. I think this observation means that the whole system has not seen this as an issue, whereas the consequences — that is, a road being built and reaching its 30-year capacity in four years — has significant consequences for government, most notably where people call, because of the congestion they are experiencing after a short time, for further upgrades that the government has not planned for. Those requisite skills and having some traction right through the process to pick those things up when they are assumed and acknowledging that they are significant issues is something that we found missing.

Mr PAKULA — Is that induced demand overlay thrown over public transport projects in the UK as well, or only on road projects?

Mr WINN — Yes, they would include induced demand but it would be more of a benefit. Yes, they would include the attraction of car traffic to public transport and what that would do to road demand because you have released space and there is a pent-up demand that is not being served.

Mr ANGUS — Mr Pearson, just following on from this discussion I have two components I would like to ask you about. Firstly, in relation to — and following on from Ms Hennessy's question — other jurisdictions, are there some obvious other best practices operating regarding these sorts of projects in other jurisdictions? Secondly, do you see a role or a capacity for the auditor as the genuine independent player in this to get involved earlier on, particularly, say, in relation to potentially a review of business cases, given that you have identified so clearly in your submission the fact that there has been an over \$2 billion overrun in recent projects?

Mr PEARSON — You will put me at odds with senior public service colleagues. My answer to the last one is no. I draw a distinction between the Auditor-General and the public sector auditor and commerce and industry. Big professional services firms provide audit services and consultancy services, and in that context my office would have the skills to do it, but when you look at it in the Westminster system, the executive is responsible for the delivery and their accountability extends not only into delivering but demonstrating that they are delivering efficiently. That brings it back — so from a principle point of view I would prefer to keep the auditor as the independent, impartial auditor. But the sort of role, the equivalent to that the consulting arm of a professional firm to a company would be providing, I suggest should be coming from the portfolio department or a central agency such as DPC or DTF. That would be the appropriate place for that to happen. Then we as the auditor are in a position to audit the effectiveness of that as well as the broader program delivery. That is the principle answer.

There are exceptions, probably more notably in other jurisdictions, in relation to sensitive things like government advertising where the Auditor-General has been brought in. In the commonwealth sphere the Auditor-General was brought in and has subsequently been replaced by a specialist board. I am aware in Ontario in Canada. I think that any government advertising campaign above a certain amount goes past the audit office. The government commitment, apparently, is that unless the audit office ticks that it passes the criteria, it does not operate. So there are variations on the theme, and as Parliament's auditor you do what you are told to do, but my principle would be preferably not.

Coming back to the other point, I will ask my colleagues in terms of other jurisdictions of better practice. My observation, having moved around the country, is that I think Victoria has the advantage of size but with it there is a bit of a disadvantage, and that is what I probably observed. There is a bit of a culture. We have not quite joined up our large and complex, so at one level I would argue that we are too process orientated. At another level we have not got the traction. We might be investing too much in process but not enough in making it work. As I said, my only comment is that there is an elusive element in here, and I think it is a complex mix of managing expectations and purposeful management. That is easier said than done, and it is made harder in the public sector where, if I draw the comparatives with our private sector counterparts, they tend to be far more quantitatively driven and shorter on feedback loop. A lot of our initiatives in the public sector are more subjective and they are much longer term, so you lose the ownership over time. They are the challenges we are facing.

Mr WINN — I can speak mostly about the transport field. In some of our audits we have advised agencies. They have said, 'Do not just tell us what is wrong, tell us where to look'. We have actually done that and pointed them towards practice that really is available. Say, for example, some things in transport in the UK — there are things that are readily available that they could look at and apply. I guess sometimes it is recognising that you have actually got a problem here, that there is something you need to address.

Mr O'CONNOR — The only organisation I am across is Infrastructure Australia. It is not an independent body as such; it has a coordinator-general but it is quasi-independent. I was quite impressed with their approach when they were first established. They talked about what they called 'the primacy of the BCR' — BCR is benefit-cost ratio. They said, 'Unless you can prove that you have the workings and the data and the project to support that BCR, that project is not going to get anywhere near the funding process'. New South Wales Treasury to a degree also separated, particularly for PPPs, the decision to provide the service from the process or the cost of actually funding it. So what they would say is they would objectively look at the need and then, once they had decided that the need had been fully analysed and all the options had been considered, the question of the procurement model became a second order matter. If it became a PPP, that is the procurement process that they went down et cetera.

Even though in Victoria we have lots of good guidance, particularly investment life cycle guidance around capital projects, there are not necessarily proscriptive or required processes in order to stop a dodgy project from getting funded. Sorry to use such frank words.

The CHAIR — It is what we like.

Mr O'CONNOR — So the process is more defined by what gets through, the lemons that make it rather than the good oranges that progress in an orderly way. I think that perverts and dilutes all that hard work of all the other public servants and all the other specialists who contributed to positive projects. Once again, that is a question for government to resolve and, as the Auditor-General said, for executive government to take responsibility for. We pick it up and we report it, and you can see it drives a lot of our submissions, but once again we have a selection bias, I guess, to the challenge projects, and really there is a great opportunity for central agencies to speak about better practice and to objectively describe that, which does not really occur in any way at the moment — not that I am aware of.

The CHAIR — But you just made the point that you have a selection bias in terms of the projects you review, which will distort inevitably your overview of the process, surely.

Mr O'CONNOR — It may. We do not have 'control', so we do not really know. However, because our selection process is based on risk and materiality, we tend to look at the higher value, higher risk, which are very similar words to what our clients are using.

The CHAIR — Yes, we have heard that before.

Mr O'CONNOR — We do tend to look at projects that are going to be spending more public money and are more likely to have a higher degree of risk — but so is Treasury. I guess it is going to be interesting in two years time to see whether there is less for us to report about because their processes picked it up, but the future is uncertain.

Mr PEARSON — I accept we do not have 'control', but what worries me are our underlying findings in terms of aggregating a report. If that is not being done in respect of a high risk area, my judgement would be it is unlikely it is being done universally.

Mr SCOTT — This is a slightly different question. As far as I can tell, this is the only evidence that has tendered statistical material relating to overall cost overruns. Part of the role that we are undertaking as a committee is really a comparative analysis. I seek some information or guidance, since you are the only persons who have provided that sort of material. Beyond Flyvbjerg — my Danish is not fantastic, so forgive a mispronunciation — are there any other places where there would be good material, that you are aware of, since you are the only group who have tendered such evidence, where information could be gleaned for the committee's benefit? A critical part of the report we are undertaking is looking at the comparative analysis around overrun or performance over or under.

Mr O'CONNOR — I will start with the UK. There was a very important study done by Mott MacDonald — it is probably 10 years old now — where they looked at the cost performance of PPPs and traditional procurement, although it has been criticised in the literature as having a selection bias, but different from the selection bias we may be accused of. HM Treasury actually provided the list of projects to them to review, so there was a question as to whether they gave them the better projects, particularly the better performing PFI projects, but it is an interesting benchmark study.

There have been two studies of a similar ilk in Australia, one funded and sponsored by Infrastructure Partnerships Australia, who I believe you are interviewing tomorrow.

The CHAIR — Today.

Mr O'CONNOR — One was done by the Allen Consulting Group and Professor Duffield is also a witness. They did a benchmark of the performance of PPPs in Australia. Then there was a follow-up study that was done by Melbourne University, to try to replicate some of the findings that were coming out of Professor Flyvbjerg's work, but also to try to replicate work that was done in response to Mott MacDonald. My understanding, from talking to Professor Duffield, is that he was provided with a whole range of datasets from a number of treasuries

and he got to choose which projects — he was able to randomly choose the projects. I guess the only criticism is that that data is not necessarily publicly available, so the quality of that data is still subject — it is internal, confidential data held by those treasuries. Projects are of course de-identified, so it is actually impossible to know which project is being mapped.

They are interesting studies, I think, and I am happy to provide a list of those references to the secretariat. They may be useful for you. They are readable; they are not too academic.

The CHAIR — We are short of time, so I am going to ask Mr O'Brien to refer to a matter. Before so doing, I want to pick up on the general context of other resources, sources of good information. You have talked about other jurisdictions within Australia, but do you have a view about international jurisdictions where there positive learnings? We can understand that Australia is not unique in the world and that what we are doing is replicated elsewhere. Do you have a view about it?

Mr PEARSON — Not specifically. My intuition is to go to the UK as probably the most relevant. As Mr Winn has mentioned, their policies in the transport area and things like that to me are relevant. Canada would be my second choice, but I do not have as precise a reason for saying that. Their auditors do a lot of value for money work, so there is a lot of that evaluation going on.

Mr O'BRIEN — I wish to take up a phrase you used in your oral evidence. It was not in your submission. There has been some discussion about it, and I take some interest in it. You have identified the problem of retrofitting a project to an announcement, and you particularly made reference to that where there is a public statement of a figure or a budget, perhaps, before there has been a rigorous business case. Maybe you need to provide further material to the committee on this, but can you explain what you mean by that in terms of the problems caused by it? Are there examples in your audit reports or otherwise where you have identified this phenomenon?

Mr O'CONNOR — I can give two examples, actually. They are contained in one report, which is the *Funding and Delivery of Two Freeway Upgrade Projects*, tabled four years ago. The first one — there was retrofitting of a budget announcement by the then minister for transport and also the procurement model, which was an alliance. What we found and what we say in the report was that the options analysis process was very flimsy in terms of the procurement choice. Likewise the dollar figure that was announced came from a commercially agreed sum with Transurban rather than any baseline work as to what the true cost of the project would be. That is a clear case where the procurement model and the cost of the project were announced prior to any of those detailed workings.

Mr O'BRIEN — Just to pause you there, what does that do, in reference to that example, to the subsequent ability of government to get best value for taxpayers money in relation to delivery then?

Mr O'CONNOR — I think you situate the analysis and you set the mold early, and you basically invalidate other potential options. You may artificially cap the true cost of the project and then cut corners or de-scope required elements.

Mr O'BRIEN — You could also artificially inflate the project, because the contract is effectively — —

Mr O'CONNOR — Potentially, if you have announced it publicly. The bidders have a pretty good idea. It is a bit like price intervallling; they know what you are willing to pay. It is very difficult then to maintain any sort of commercial tension, I think.

The second one would be another which is in the same report. It is the M1 upgrade, which was announced via press release once again as a \$1 billion project. It eventually became \$1.3 billion.

The CHAIR — So is that a cost overrun?

Mr O'CONNOR — It was reannounced as \$1.3 billion, so I guess they did the right thing where they publicly admitted that the first cost was optimistic. I guess that did not necessarily stop that project from proceeding, but it was very early in the day when they announced that figure — when they were trying to actually put together three separate alliances. I think everyone had a pretty good idea of what each section of the works was likely to cost and where to pitch their bids.

Mr O'BRIEN — Just on notice perhaps, given the time — —

Mr O'CONNOR — It is in our report.

Mr O'BRIEN — It is in that report, but in relation to the evidence for this committee could I ask you to take on notice this phenomenon, because you have not covered it in writing, and to perhaps reduce some of your further comments to writing, perhaps with other examples or even a list of other projects where you believe this phenomenon has materially affected the result?

The CHAIR — Thank you very much. That concludes the hearing for the Victorian Auditor-General's Office. I thank the Auditor-General and departmental staff — his officers — for attending today. It has been a very useful session. Where questions were taken on notice or were asked, the committee will follow up at a later date. We will be pursuing a number of issues, particularly case studies, and we look forward to your input at a later date. The committee requests written responses to any matters we raised within 21 days. I would also be pleased for any supplementary comments to the committee as a consequence of any of the submissions made or the hearings as they progress which come to your attention and upon which you would wish to comment. Thank you very much. That closes this hearing.

Witnesses withdrew.