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Victorian Auditor-General's Office

9 November 2011

File no.: 13.02.01/5

Ms Valerie Cheong
Executive Officer
Public Accounts and Estimates Committee
Parliament of Victoria
Spring St
EAST MELBOURNE VIC 3002

Dear Ms Cheong

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

Thank you for your invitation for this office to make a submission to your *Inquiry into Effective Decision Making for the Successful Delivery of Significant Infrastructure Projects*. My comments build on issues discussed at the meeting with the Committee on 7 November 2011.

Attached is the Victorian Auditor-General's Office submission. A copy of this will also be sent by email.

I would welcome the opportunity to complement this submission by further meetings with the Committee both to round out this written submission and respond to and comment on issues raised by other submissions.

Thank you for the opportunity to contribute to this Inquiry.

Yours sincerely

[redacted]

D D R PEARSON
Auditor-General

Public Accounts and Estimates Committee

Submission No. 4

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PUBLIC ACCOUNTS AND ESTIMATES COMMITTEE

Level 24, 35 Collins Street, Melbourne Vic. 3000
Telephone 61 3 8601 7000 Facsimile 61 3 8601 7010 Email comments@audit.vic.gov.au Website www.audit.vic.gov.au

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Victorian Auditor-General's Office submission to the Public Accounts and Estimates Committee's Inquiry into Effective Decision Making for the Successful Delivery of Significant Infrastructure Projects

1. Contextual overview

Infrastructure in Victoria – scale, type and role

- Public infrastructure is a key social and economic enabler for a modern economy.
  - In 2011-12 and future years Victoria will spend more than $1.7 billion in new infrastructure projects across the public sector.[1]
  - The *Auditor-General's Report on the Annual Financial Report 2010-11* (November 2011) advises that the State now has 19 public private partnerships (PPP). In aggregate the present value of these contractual commitments was around $9.5 billion at 30 June 2011.[2]
- Unfortunately in Victoria, there is now close to $2 billion in known project cost overruns. In his 2011-12 Budget Overview, Treasurer Kim Wells identified these cost overruns, attributing them to poor management and under funding.
  - The Victorian Auditor-General's Office (VAGO) frequently reports on overruns such as these, which the Department of Treasury and Finance (DTF) also reports in budget papers.
  - These substantial cost overruns suggest that it is now timely that the Public Accounts and Estimates Committee looks at the effectiveness of the delivery of these projects.
- Typically, public infrastructure falls into two broad categories both of which are worthy of evaluation and inquiry, as both have social and economic value:
  - 'Hard' economic infrastructure which helps to move freight for import, export or internal trade. Freeways, tollways and ports fall into this category. Privatised electricity and gas grids also fit into this category.
  - 'Soft' social infrastructure includes schools, hospitals, research facilities, courts and convention centres. These play a key role in allowing State-run or State-sponsored services for citizens to be effectively deployed in a modern and fit-for-purpose environment.
  - Some types of infrastructure span across these 'hard' and 'soft' domains. For example, a State-provided public transport system can reduce road congestion and pollution, bring employees to and from home and work, get students to schools, TAFEs and universities, and give pensioners mobility when they are perhaps no longer safe or comfortable to drive private cars.

Public sector major infrastructure projects are inherently risky

It is important to keep in mind that the track record for public sector projects in meeting time and cost targets is particularly poor. Cost and time overruns are endemic across the world.

- Professor Bent Flyvbjerg's 2009 research on worldwide project outcomes has shown average construction project budget overruns of close to 50 per cent for projects between €10 and €150 million, with average IT project overruns of up to 500 per cent for the largest projects.[3]

In an environment where public revenues are flat or decreasing, it is time to address these overruns through more project discipline, greater competence and by making sure that the public interest is at the forefront in all phases of project planning and delivery.

[1] *Victorian Budget 2011-12 Strategy and Outlook, Budget Paper 2,* 2011 p4.
[2] Current figures on the *Partnerships Victoria* website state that there are 21 *Partnerships Victoria* projects currently in existence worth around $10.5 billion in capital investment.
[3] Flyvbjerg, B 2009, 'Survival of the unfittest: why the worst infrastructure gets built—and what we can do about it', *Oxford Review of Economic Policy*, vol. 25, no. 3, pp. 344-367

Changing delivery mechanisms

Understanding the need for a new piece of infrastructure is critical – but being able to deliver it for the best price within optimal time and quality parameters is a task that requires a high level of conceptual and practical skill.

To keep pace with these challenges, the way Victoria delivers infrastructure has changed over the past decades:

- Although public infrastructure is authorised and regulated by the State, the State does not always directly design or build these facilities. Many major projects are now delivered through partnerships with the private sector, using a range of new procurement models.
- As the size and scale of infrastructure projects grows, so too does the complexity of the procurement choices for government.
- However, traditional 'price taking' procurement still accounts for the bulk of public sector infrastructure procurement.

Governance arrangements for major infrastructure projects – role for central agencies

VAGO's audits and sector scanning have identified that DTF has been an active participant in developing better practice guidance in regard to capital projects, through initiatives such as the:

- Investment Lifecycle Guidance
- Gateway Review Process
- the new 'High Risk – High Value' internal project screening process.

DTF, however, has faced a degree of 'role conflict' over the last 10 years in regard to major infrastructure projects, being both an active player and decision maker, as well as carrying the responsibility to conduct robust and independent reviews of these same projects.

The Gateway Review Process has been held up by some as an assurance process, or a safety net to correct deviation in major projects.

- However - VAGO has seen examples where sponsors of large projects have actively avoided the process with no real sanction from DTF.

This highlights a core governance challenge for the role of central agencies in the development of major infrastructure projects – the need for systematic monitoring of the actions taken in response to DTF recommendations.

- It is not always clear whether agencies act on Gateway findings or indeed on the broader guidance provided by DTF.

2. Key audit findings

Infrastructure projects are the subject of significant and ongoing audit attention in Australia. There are a number of aspects of infrastructure development and implementation where VAGO's audits have had significant findings.

VAGO has the following comments to make on the terms of reference, based on our audit reports.

Oversight deficit – government and central agencies

Recent and current audit experience suggests that greater use could be made of central coordination. Agencies often work outside centralised oversight. Although there is guidance available from centralised expert agencies, the effectiveness of guidelines will be limited if there is insufficient monitoring of compliance with these guidelines.

Central leadership and coordination is needed in infrastructure development and management, where projects often involve complex, high-value contracts which some government agencies have limited experience in managing.

- Recent reports show that some sections of the public service do not have the capacity or capability to manage major projects. Greater central leadership and coordination for the duration of project development and implementation and for the lifecycle of the asset is required.
  - *Management of Prison Accommodation Using Public Private Partnerships* (September 2010) found that while the Department of Treasury and Finance supports the procurement phase of PPP projects with considerable resources, there is a need for greater support to the Department of Justice in this case and other departments in the operation phase of such contracts.
- Leading agencies cannot rely solely on providing guidelines. VAGO audits have found examples of insufficient leadership leading to a lack of sufficient oversight and compliance monitoring commensurate to the risk of the project and expected returns for the public's investment.
  - *Biotechnology in Victoria: the public sector's investment* (August 2011) found that because DBI's grants to the biotechnology sector do not meet the technical definition of asset funding, it does not attract the typical central agency scrutiny or mandatory processes that apply to asset funding including benefits measurement.
  - *Victorian Life Sciences Computational Initiative* (June 2011) found that the University of Melbourne did not get anyone to check whether it completed tasks in its probity plan, which was developed to support compliance with Victorian Government Purchasing Board guidelines.
  - *Business Planning for Major Capital Works and Recurrent Services in Local Government* (September 2011) found that while councils are required by legislation to submit plans to the Minister for Local Government through Local Government Victoria (LGV), LGV does not scrutinise the basis of individual council plans and budgets. Consequently, systemic coordination and continuous improvement opportunities are not being realised.
- Audits have also identified good initiatives to improve central coordination within departments that are familiar with infrastructure development and implementation. In the 2011-12 budget, transport projects accounted for around 38 per cent of total estimated investment. In 2002, the Department of Transport established a Project Review Committee to review business cases.
  - *Management of Major Rail Projects* (June 2010) found that over time this committee became the central mechanism for reviewing business cases.

Accountability mechanisms need to keep pace with new service delivery mechanisms

The Interim Report of the Independent Review of State Finances (April 2011) emphasised the importance of considering outsourced and private sector solutions in providing infrastructure to Victorians, stating that 'some public services will be delivered through the private sector'.

It is, however, important that these instruments are used in an efficient and effective manner, where they still involve public funds. To assess this, these arrangements must be subject to appropriate checks and balances.

- Private sector partnerships do not always meet current Government (Treasury, Partnerships Victoria) policy requirements for accountability and audit. This is especially concerning, as the audit mandate cannot 'follow the dollars' into this sector. For example:
  - *Management of Prison Accommodation Using Public Private Partnerships* (September 2010) found inadequacies in the oversight arrangements in contracts and contract management.
  - *Towards a 'smart grid' – the roll-out of Advanced Metering Infrastructure* (November 2009) found that the private sector partnership was avoiding checks and balances that would ordinarily apply to major investment, and an 'oversight gap' had emerged between the Department and private sector partners.
  - *Portfolio Departments: Interim Results of the 2009-10 Audits* (July 2010) reporting significant weaknesses with the way Departments monitored performance of major outsourced IT providers.

- Transparency of measurement of costs for PPPs could be enhanced. The *Auditor-General's Report on the Annual Financial Report of the State of Victoria 2010-11* (November 2011) reported that the total cost of PPPs to the state is generally more than the contract cost disclosed by the portfolio agencies and in the Annual Financial Report. This is because the state can incur significant additional direct costs relating to those projects, such as land acquisition.
  - While financial statements of agencies and the AFR are prepared in accordance with Australian Accounting Standards, the standards do not require all costs associated with a project or its development to be drawn together. Consequently, a reader of the financial statements may have difficulty in identifying and isolating the total costs associated with individual capital projects.
  - Australian Accounting Standards set the minimum requirements for accounting and disclosures, however, in the interests of better informing stakeholders, this should not preclude entities from making additional disclosures. For the public sector, a higher level of disclosure around PPP projects should be adopted to increase transparency and to minimise opportunity for ambiguity and misunderstanding.

Information to decision makers

When making major investment decisions, decision-makers need to be fully informed to be able to assess whether these significant spends are value for money and will achieve desired outcomes. Audits often focus on this area of performance by government agencies.

- Audits have often found examples where information to decision makers has been unreliable, incomplete or not soundly based.
  - *Irrigation Efficiency Programs* (June 2010) found that decisions to invest around $2 billion in infrastructure projects were poorly informed. Advice to decision-makers was based on unverified assumptions and unproven technology. Consequently, it is uncertain that the assets will achieve the intended water savings.
  - *Management of Major Road Projects* (June 2011) found business cases and project scope reports had insufficient information justifying the traffic forecasts and economic benefits. This may have resulted in decision-makers getting false confidence about the likely outcomes and the extent of benefits.
  - *Business Planning for Major Capital Works and Recurrent Services in Local Government* (September 2011) found that three of the four councils audited could not demonstrate that councillors received enough information to assess if investment decisions were sound.
  - *Management of Major Rail Projects* (June 2010) found that objectives for the projects could have been more precise, clearly structured and streamlined, to allow decision-makers to make an effective procurement decision.
- Strong business cases are critical in infrastructure development and audits have found examples of both strong and weak business cases.
  - *The New Royal Children's Hospital – a public private partnership* (May 2009) found that the business case was comprehensive and incorporated the key information and analysis required by *Partnerships Victoria* and other guidelines.
  - *Audits of 2 Major Partnerships Victoria Projects* (November 2007) found that there was a comprehensive, evidence-based business case for the Melbourne Convention Centre development.
  - *Management of Major Road Projects* (June 2011) found that even for fast-tracked projects, there need to be minimum standards for the business case and agencies should clearly describe the effects of fast-tracking on the reliability of the business case information.

  - *Business Planning for Major Capital Works and Recurrent Services in Local Government* (September 2011) found that investments in capital works are not supported by rigorous business cases at three of the four councils examined. This provides little comfort that these councils' investment choices are sound and support their long-term objectives.
- Business cases should be revisited at key stages to confirm the project is still value for money.
  - *Management of Prison Accommodation Using Public Private Partnerships* (September 2010) found that before accepting the risk of energy costs, the Department of Justice did not update its tender evaluation for the increased costs of this proposal to the state, to determine whether this proposal still represented the best value for the state. A Ministerial brief did not note the costs to the state or future risk that the state was assuming.

Asset information and reporting

Good asset information supports good performance and allows decisions that enhance value for money. There are, however, opportunities to better measure and utilise asset information.

- Benefits realisation of assets cannot be achieved without appropriate measurement.
  - *Management of Major Rail Projects* (June 2010) found that the department is not able to demonstrate how well projects have realised their intended benefits.
- Leveraging accrual accounting. Measuring financial sustainability provides management with information that can be used to identify risks through examination of key performance indicators. One indicator includes the 'investment gap', which measures whether an agency has been replacing assets at a rate consistent with their consumption.
  - *Local Government: Results of the 2008-09 Financial Audits* (November 2009) found that over the previous five years, spending on infrastructure increased when compared with the level of depreciation.

Procurement approaches and processes

- Private sector partnerships can provide benefits to asset management, both through providing capacity to increase investment and by building in commitment from commercial partners for the whole life of an asset, leading to a 'new realism of costing and planning'. But the public sector must contract wisely or asset condition and management can suffer. Further, responsibilities do not end with signing of contracts (*Buy-back of Regional Intrastate Rail Network*, June 2009; *Management of Prison Accommodation Using Public Private Partnerships*, September 2010). Infrastructure PPPs need:
  - Clear objectives, policy and directions
  - Sound business cases
  - High level of expertise
  - Appropriate allocation of risks to private sector operators
  - Focus on value for money across the whole life cycle of the project.
- Transparency around procurement method choice has been examined in recent audits, where there were examples of both appropriate levels of transparency, as well as shortcomings in analysis to support the chosen procurement method.
  - *Audits of 2 Major Partnerships Victoria projects* (November 2007) found that during the development of the Melbourne Convention Centre, probity was enforced and maintained through all key procurement stages, probity and other relevant procurement requirements were met and appropriate records on the procurement were being maintained.
  - *Management of Major Road Projects* (June 2011) found that there was no assurance of the reliability of the estimated difference between the costs of delivering the project through a PPP compared to a state-financed public sector comparator.

- *Management of Major Rail Projects* (June 2010) found for the three projects examined that used a project alliance, there was insufficient information to fully explain why an alliance gave better value for money than options promoting more competition.

- Poor contract design can have negative impacts on infrastructure assets as gaps or shortcomings in contracts reduce incentives on private partners to maintain assets appropriately.
  - *Buy-back of Regional Intrastate Rail Network* (June 2009) found that the lease had inadequate maintenance obligations. Lower than expected revenues for the private operators impacted on maintenance spend and the maintenance backlog increased while it was in private hands. Operators took a minimum approach and allowed some lines to fall out of service.
  - *Management of Prison Accommodation Using Public Private Partnerships* (September 2010) found that ineffective contracts led to a lack of assurance that assets are being appropriately maintained, and it is likely that the state will receive the assets back in a poorer condition than expected.

Managing risks during implementation

- Risk management – In procurement partnerships, the management of risks including clear allocation of risks is critical. Audits have revealed examples of both effective and ineffective risk management by departments.
  - *Management of Major Rail Projects* (June 2010) found that the department's improved management of project risks during delivery has been reflected in better performance against planned time lines and approved budgets.
  - *Audits of 2 Major Partnerships Victoria Projects* (November 2007) found that in the management of the Southern Cross Station redevelopment PPP, operational risks were allocated appropriately with commercial operational risks allocated to the concessionaire and contract management risks remaining with the Southern Cross Station Authority.
  - *Management of Prison Accommodation Using PPPs* (September 2010) found that DOJ had no risk management plans for the four PPP prisons. As a result, it is not possible to reliably assess whether risks to the state are being managed effectively.

Underestimation of costs and overestimation of benefits

- Time frame slippages or cost overruns can arise because an overly optimistic view was formed early in the investment's life about the practicalities and logistics of the implementation.
  - VAGO's better practice guide, *Investing Smarter in Public Sector ICT* (July 2008), while focused on ICT investment, is a relevant reference for all infrastructure development projects.
  - *Auditor-General's Report on the Annual Financial Report of the State of Victoria* (October 2010) found that the cost of both the Monash-West Gate Freeway upgrade works and the West Gate Bridge strengthening works increased. The original total 2006 budget of $977 million was increased to $1 340 million in 2007 to cover an underestimation of costs, to remediate contaminated land, manage traffic during road works to minimise congestion, and to minimise revenue losses to Transurban.