VERIFIED TRANSCRIPTS

PUBLIC ACCOUNTS AND ESTIMATES COMMITTEE

Audit review on

Funding and Delivery of Two Freeway Upgrade Projects

Melbourne — 29 April 2009

Members

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Mr J. Fitzgerald, Deputy Secretary, Commercial Division,

Mr J. Loos, Assistant Director, Commercial Advisory Services, and

Ms N. Opie, Senior Project Manager, Victorian Water Plan Infrastructure Projects, Department of Treasury and Finance.

The CHAIR — I declare open the Public Accounts and Estimates Committee hearings into the review of the Auditor-General's audit findings and recommendations, August 2007 to February 2008 addressing the following audit: *Funding and Delivery of Two Freeway Upgrade Projects*. I welcome Mr John Fitzgerald, Deputy Secretary, Commercial Division; Mr Jason Loos, Assistant Director, Commercial Advisory Services, and Ms Natalie Opie, Senior Project Manager, Victorian Water Plan infrastructure, Department of Treasury and Finance. Members of the public and the media are also welcome.

According to 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 deputy secretary, can approach the table during the hearings. Members of the media are also requested to observe the guidelines for filming or recording proceedings in the Legislative Council committee room. All evidence taken in this committee is taken under the provisions of the Parliamentary Committees Act and protected from judicial review; however any comments made outside the precincts of this 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 proofed versions of the transcript, to be verified and returned within two working days. In accordance with past practice, the transcripts and PowerPoint presentations will then be placed on the Committee's website.

Following a presentation by the Department of Treasury and Finance, committee members will ask questions relating to the audit findings and recommendations. Generally the procedure will follow that related to questions in the Legislative Assembly. I ask that all mobile telephones be turned off, and I now call on the deputy secretary to give a presentation on the Funding and Delivery of Two Freeway Upgrade projects audit.

Mr FITZGERALD — By way of introduction, on 20 March 2009 PAEC sought details on actions undertaken or that are undertaken by DTF to address the recommendations made by the Auditor-General in his report *Funding and Delivery of Two Freeway Upgrade Projects*. DTF provided a response on 20 April this year to a detailed set of questions pertaining to the Auditor-General's findings and recommendations on funding and delivery of two freeway upgrade projects.

I am appearing on behalf of Mr Grant Hehir, Secretary of DTF, to elaborate on the DTF response to the Committee and answer any further questions. DTF is responsible for developing policies and guidance material across a range of areas, including procurement and asset investment. These policies and guidelines include the Victorian Government Purchasing Board policies and guidelines, which set minimum standards for procurement of non-construction goods and services in Victorian government departments and some agencies using the *Investment Lifecycle Guidelines*, Gateway review guidelines, Partnerships Victoria policy and guidelines and *Project Alliancing Practitioners' Guide*. These materials are developed in consultation with practitioners and stakeholders and are periodically revised and updated to reflect lessons learnt and the evolving market practices. The application of these policies is promoted through the internet, training and seminars offered by the department, as well as direct advice provided to agencies through our client service areas.

The Tullamarine–Calder Interchange, referred to as the TCI project, was the first alliance agreement entered into by VicRoads and one of the first alliances in Victoria. Specifically the business case for this project was prepared and submitted two years before the DTF's alliance and better practice guidelines were released. DTF observed and participated in key aspects of the project, including selection of partners and project delivery. As such, much of the experiences and learnings of the TCI project were captured, and key personnel from the TCI project were involved in the development of the procedures and good practice standards reflected in the DTF *Project Alliancing Practitioners' Guide*.

DTF continues to monitor industry developments, and DTF's alliancing team has commenced working closely with VicRoads on its planning on alliancing projects of the M80, which is an upgrade between the airport and Sydney Road; Anthony's Cutting, a section of the Western Highway near Melton, north-west of Melbourne; and the Springvale Road upgrade. VicRoads has requested DTF's input and critical review of its planning processes and resourcing of alliancing.

To VicRoads' credit, it has sought a before-and-after assessment by the DTF alliancing team of VicRoads capability during the course of those projects. It is still too early for DTF to comment authoritatively on the planning processes and resourcing of VicRoads through the alliancing projects identified above. We commend

VicRoads on its strong appetite for continuous improvement and ongoing attention to the development of its capabilities and skills for managing alliance contracts.

In respect of recommendations 3.1, 3.2, 3.3, 4.1 and 4.2 of the Auditor-General's report, I would like to make a number of comments. A number of the recommendations dealt with the content of business cases, and I note that VicRoads accepted these recommendations and amended their internal guidance material accordingly. DTF recognises the importance of robust analysis as part of the business case process, as this ensures that government takes into account the benefits and costs of an investment proposal in its decision-making process. DTF works with VicRoads to assist them in the development of their investment proposals and also advises VicRoads on the consistency of these proposals with the recently released *Investment Lifecycle Guidelines*, in particular, business case development.

In respect of recommendations 3.7, 3.8 and 3.9 of the Auditor-General's report, DTF is currently developing supplementary guidance on project governance. This subject is covered briefly in the current *Investment Lifecycle Guidelines*, but not to the level of recording standards for documenting meetings, decision making and ensuring an audit trail. DTF sets higher level policy guidance; it does not and will not provide guidance at this administrative level. Departments are encouraged to develop more detailed guidance, where required, for their agency. The former Department of Infrastructure, now the Department of Transport, has developed detailed guidance for governance such as steering committee composition and processes, including the recording of decisions and risk and issue registered templates and so on. It is understood that these have been made available to VicRoads.

The *Investment Lifecycle Guidelines*, the Gateway review process and the alliancing guidelines all have an expectation of a post-commissioning review to establish suitability for purpose benefits achieved against expectations and issues with the process. These matters are vital to accountability, future management and learning for future projects. VicRoads is cognisant of the various policies and guidelines and is seeking to incorporate stronger project, assurance — for example, through the use of the Gateway reviews — to improve project outcomes. VicRoads project managers are liaising with the Gateway unit in DTF to ensure timely scheduling of reviews for their projects, including the Gateway 6 review benefits evaluation on the TCI project, which is likely to occur in July this year.

In relation to alliancing, the *Project Alliancing Practitioners' Guide* was released in April 2006 by DTF. It incorporates a value-for-money reporting requirement to encourage the capture of lessons on specific projects. DTF has initiated an extensive review of the government's position regarding the delivery of alliance projects. This review is being conducted collaboratively with the treasuries of Western Australia, Queensland and New South Wales. The treasuries of Victoria, Western Australia, Queensland and New South Wales have established a steering committee chaired by Victoria for the following work program: the planning and implementation of a national alliancing benchmarking study entitled 'In pursuit of additional value'. Academic and industry experts have been appointed to conduct this benchmarking study.

Separate state-based reference groups, including one made up of members of the Alliancing Association of Australasia, are being established. The study is expected to be completed in August this year. The aim of the study is to dimension the incremental value-for-money opportunities offered to government and the taxpayer by project alliancing delivery as compared against alternative procurement models; develop a set of common principles that each member state would be comfortable to adopt; redevelop the current Victorian alliance guidelines in line with benchmarking study insights, lessons learnt and new policy principles into guidelines that each state would be comfortable to adopt; develop and recommend training programs that support the new policy and guidelines; and, finally, receive and monitor feedback from key stakeholders.

The CHAIR — This is the submission you sent us?

Mr FITZGERALD — Predominantly, yes.

The CHAIR — You can particularly focus on anything additional you have to your submission.

Mr FITZGERALD — I have only got a couple of minutes to go. In addition to the above initiatives, the steering committee is considering other specific matters for analysis and consideration — for example, project alliance and insurance. In respect of recommendations 3.4, 3.5, 3.6, 4.3 and 4.4, the Victorian Government Purchasing Board's good practice guidelines on the conduct of commercial engagement in government, which deals with the probity standards and the application of probity auditors and advisers, are subject to ongoing review. It is likely that these guidelines will be reviewed in the near future, either as part of the normal refreshment process or as part of the broader policy review arising from the FMA reform project.

The respective roles and the suggested templates for both sign-offs are appropriately detailed and explicit in the DTF good practice guidelines. The utilisation of separate probity auditor and probity adviser roles in any one project is best left to the department's responsible officer. It is not always correct to assume that major projects — 'major' in the sense of costs — have more probity risks than smaller projects. The existing guidelines promote a determination of the extent of the external probity effort based on an assessment of the probity effort required commensurate with the probity risks.

The CHAIR — Thank you very much for that. It might be useful in helping us complete our report — you mentioned a couple of major guidelines, et cetera, there; is it possible to get a copy of those?

Mr FITZGERALD — Yes.

Ms MUNT — Thank you, Chair. I would just like to ask a question about the decision-making process for the procurement, for the TCI in particular — I think the M1 was a different process. I refer you to page 42 of *Funding and Delivery of Two Freeway Upgrade Projects*, a report of the Auditor-General. I will quote from that:

> The state did not conduct a formal, documented risk assessment of either encashment transaction. This notwithstanding, the state did identify the major risks relevant to the transaction and employed effective strategies to manage the risks that were identified.
>
> In addition, the state identified that there were risks for the state by holding the concession notes. Accordingly it was concluded that there were significant advantages in relation to risk mitigation to the state in encashing its interest in the concession notes, as part of the financing arrangements for the M1 upgrade project.

Further back in the report it actually talks about the process that was gone through by the Department of Treasury and Finance where an independent adviser was actually employed — is that correct? — to make recommendations to you. Can you just take me through that process a little bit further?

Mr FITZGERALD — Yes. It was a long time ago, and it was not specifically sought in these proceedings.

Ms MUNT — It is part of the Auditor-General's report.

Mr FITZGERALD — There was a process. We went through a process of appointing an adviser. There was the appointment of an adviser, which was Rothschild at the time. They did provide DTF with advice on the transaction.

Ms MUNT — That was the process that you went through for the procurement of these two projects? What process was actually gone through?

Mr FITZGERALD — That was the process we went through for the appointment of an adviser on the negotiations on the concession notes. In fact I think that is where I would see some separation in terms of the questions that have been raised here and the terms of reference for this inquiry, because that adviser was specifically used for the negotiation of the concession notes not for the process of development of this project as a capital project.

Mr WELLS — On page 30, 'Assessment of the alternatives' regarding the M1 project, the Auditor-General states:

> The analysis did not set out any information in relation to the alternatives beyond the next five years nor did it consider how any debt financing might be repaid in the future.

Then the Secretary of the Department of Treasury and Finance stated:

> It was unnecessary to explicitly 'consider how any debt financing might be repaid in the future' because:
>
>> it would have been repaid out of budget surpluses …

Why did your department make that comment?

Mr FITZGERALD — Can you refer me to the page?

Mr WELLS — Sure. Page 30, the Secretary's comment where he stated:

> It was unnecessary to explicitly 'consider how any debt financing might be repaid in the future' because:
>
> > it would have been repaid out of budget surpluses …

What I want to know is why the Department of Treasury and Finance made that statement.

The CHAIR — Where is the Secretary's statement?

Mr FITZGERALD — I cannot see it, sorry.

The CHAIR — It is not on page 30.

Mr WELLS — I am sorry — page 4. Page 30 is where it is set out and on page 4 is the response provided by the Secretary of the Department of Treasury and Finance. The fourth dot point down: 'It was unnecessary to explicitly …' blah, blah, blah. The question is: why did the department make that comment.

Mr FITZGERALD — It goes on to say:

> The potential contribution of concession fees to such surpluses was considered as part of assessing the appropriate discount rate on the concession notes.

They are two separate issues. To consider how any debt financing might be repaid in the future, if the state undertook the financing of this project — and I think this is the point — it would not have debt financed it; it would have been paid out of surpluses. Government would have had to find the money from budget surpluses in the forward years to actually pay for the project.

Mr WELLS — But you are not answering the question. The reason I am asking is because the department has responded in a particular way, that it did not have to set out a debt repayment plan because the payments would be made out of budget surpluses. What I am wanting to know is, on what logic have you based that response to the Auditor-General's report?

Mr FITZGERALD — I think the point of that answer is VicRoads does not borrow to pay for its projects. It does not borrow from TCV or from the private sector or banks or anybody. If this was a project that was being funded by government, the point is we would not have borrowed money to actually pay for this project; we would have had to pay for the project through surpluses. Hence there was no borrowing program that we had to consider in terms of how that might be repaid, because we would not have borrowed the money in the first place.

Mr WELLS — On what logic do you make that statement that all future debt-funded infrastructure projects will be repaid out of budget surpluses?

Mr FITZGERALD — Correct me if I am wrong, but VicRoads is not a borrowing authority, so VicRoads does not borrow. It is treated in the same way as a general government sector department. It is considered as part of the general government; the general government never borrows for any of its capital projects. Capital projects within the general government sector are funded through budget surpluses. The comparison to any other arrangement in terms of financing for this project always had to be surpluses and not borrowings, and therefore there is no consideration of how we would repay those borrowings.

Mr WELLS — Let me ask it a different way then. Is it still the policy of DTF that you will have debt funding that will be financed from budget surpluses? Is that still your policy?

The CHAIR — I think that might be one for the estimates rather than necessarily for the audit today, insofar as it relates to — —

Mr WELLS — No. You have answered it in a particular way in the response. I want to know whether that is still your policy. I mean, it is very clear.

Mr FITZGERALD — Our policy is still such that if a general government sector entity requires funding for a capital project, then it will be provided through government surpluses.

Mr WELLS — If we do not have surpluses, what happens?

Mr FITZGERALD — That is a decision for government.

Mr WELLS — But then that contradicts what DTF has said.

Mr FITZGERALD — If you do not have surpluses, government may borrow through a global borrowing program through Treasury.

Mr WELLS — But that is not what you have said in the response to the Auditor-General. That would be different if there are no budget surpluses. That is the point I am making — for example, if there are no budget surpluses in this budget, does this statement then become null and void?

The CHAIR — This statement was made a year and a half ago.

Mr WELLS — Yes, I know, but that is the point. That is the question: do you still have the same policy? Does DTF still have the same policy that it does not have to explicitly consider how debt financing might be repaid in the future because it would have to be repaid out of budget surpluses? The question is: is that still the policy of DTF?

Mr FITZGERALD — Yes, it is.

Mr WELLS — It is still the policy? And if there are no surpluses, what happens?

Mr FITZGERALD — You either do not undertake the project if you do not have surpluses with which to fund it, or you use your global borrowing program to borrow money I guess to pay for these projects.

Mr WELLS — Okay. How would that be repaid if there are no surpluses?

Mr FITZGERALD — That would be repaid over time from budget surpluses. You would have to actually allocate future budget allocations to meet the interest and repayment obligations that you have on the loan. But the money that government borrows through its global borrowing program through the Treasury Corporation of Victoria might fund many projects across the general government sector, so that program cannot be and is not related in any way specifically to a particular project. Any money that the state has borrowed, and it has borrowings of several billion dollars currently, that will have to be refinanced over time or ultimately repaid through budget surpluses in future years. But that is unrelated to the repayment of debt in respect of any particular project within the general government sector.

Mr WELLS — I understand that. But if there are no surpluses; that is the point — —

The CHAIR — It is a hypothetical question.

Mr FITZGERALD — You could assume there are no surpluses for ever more.

The CHAIR — You might wish to take this up further with the Treasurer next week. Insofar as we are dealing with the audit here, I am not sure we can pursue this one much further.

Mr NOONAN — I note from your opening comments, John, that you really commend VicRoads in terms of their processes. In your response you talked about their strong appetite for continuous improvement, and you actually referred to a before-and-after assessment process which they undertake as part of their projects. I wonder whether you might elaborate on the before-and-after assessment processes in terms of what you are seeing, and also talk about the DTF's role in continuing to work with VicRoads and the Department of Transport in terms of what you referred to as the *Investment Lifecycle Guidelines*, which you also referred to in your response.

Mr FITZGERALD — Perhaps I can explain the relationship with some of this guidance material. There is the investment lifecycle guidance material which does what it says it does. Sitting under that is a Gateway review process that we undertake, and they are linked. There are a separate set of policy guidelines that we now have in respect of alliancing, and our relationship — or interaction — with VicRoads is different in respect of both of those. At the time when these projects were undertaken or commenced and the Auditor-General reported we did not have our investment lifecycle guidance material available but we did have our Gateway review process.

There are six steps in the Gateway review process from the beginning of a project through to a post-project review. Those guidelines and those reviews more precisely are available to all government departments and agencies. They undertake a review process throughout the project. The review panel gives them advice along the way at each Gateway review to help them to improve their process and to make sure any gaps in the process are covered before they move on. Then at the end of that process a review team goes back to do a high level review — it takes approximately four days to undertake one of these reviews — and looks back over the project from the point of view of what could have been done better and what achievements could have been improved. There are lessons to be learnt for the project team, and we feed those lessons back into the government lifecycle guidance material which gives us some continual improvement. That is how that works.

There are the alliancing guidelines which we developed in 2006, and with some experience we are reviewing those again now. It is a little different in terms of how it works. It is a set of guidelines; it is not a policy but guidelines that again any government department or agency can use. It sets out a detailed process of the various steps for how they might undertake an alliancing arrangement. Within the Commercial Division of Treasury we participate in some of that process very much from a policy perspective. What has been learnt, and in the case of alliancing, how the guidelines are working and where they could be improved, again learning from the process. Now, close to three years on, we are about to review those alliance guidelines, as I talked to you about, with a view to improving them and taking them to a national level because other jurisdictions, particularly Queensland, now have a lot of experience in alliancing in their own right, and we want to take advantage of their experience as well.

Mr NOONAN — The guidelines were developed a couple of years after this alliance project?

Mr FITZGERALD — Yes.

Mr NOONAN — I do not think I recall the TCI project having the follow-through in terms of the development of the guidelines. Was this project one of the main examples in terms of developing the guidelines — essentially picking it apart?

Mr FITZGERALD — Yes. There was a lot of interaction with VicRoads and the experiences they had with this project. VicRoads was one of the early movers in terms of an agency that took up this type of procurement. There was a major contribution about the experience they had with this transaction in the development of those initial guidelines.

Ms PENNICUIK — There seems to be a growing enthusiasm for the use of alliances in the public sector. From your perspective what are the capabilities and skills that are vital for the successful governance and management of alliance projects, and do you foresee a growing use of them in the Victorian public sector?

Mr FITZGERALD — This has to be opinion on my behalf; it is not factual, but yes you are correct. Alliancing has been a growing form of procurement for major capital investments by governments across Australia, and we see that in Victoria. The growth in the alliancing market was actually one of the reasons why we developed some guidelines. We felt we needed something around these guidelines. There is evidence that alliances are gaining increasing momentum as a project delivery practice. Since 2005 the number of alliance projects has increased by 120 per cent. That confirms your point of view. The second part of your question?

Ms PENNICUIK — What skills and capabilities do you think are needed to manage them?

Mr FITZGERALD — They need good governance arrangements. In terms of skills, the important thing about alliances is that skills need to be equally balanced on both sides of the alliance. On the side of government, I think the most important skill is good commercial experience and acumen rather than perhaps more of a hard legal approach that we have seen in some of the D and C type or harder contracts. Certainly strong commercial skills and strong skills around good judgement are important.

I will just go on to mention that in terms of our use in Victoria, we see alliances perhaps as valuable where you are dealing with a project that has very specific or difficult risks to manage, particularly if it is difficult to understand at the outset who might be best placed to manage those risks — complex risks that are difficult to manage, and risks that are difficult to attribute to one party versus the other. We see a fairly narrow use of alliances going forward. Whilst we are hearing a lot about them and there are some large alliance projects, I think we probably will not see alliancing making up more than about 10 per cent of the total capital investment by the state.

Ms PENNICUIK — Just as a follow-up question, you are saying about 10 per cent and there is a general enthusiasm for them, what do you see the downside or disadvantages or risks in the use of alliances that we need to look out for?

Mr FITZGERALD — There is always downside to risks.

Ms PENNICUIK — We are not hearing much about them.

Mr FITZGERALD — One of the risks is having on both sides of the alliance similar skill, because alliances are based on a risk-reward formula, so you share risks but you share rewards. I think for practitioners to clearly understand the complexity of the risks and to create the right reward structure that incentivises both parties to equally get the best outcome is a major challenge in these alliances. If you do not actually spend a lot of time getting that right, I think that is where you would likely see a failure. It also relies on a lot of independent assessment of the costings et cetera associated with the construction component. They are available in the market. I think it is managing that independent costing process that is also a challenge. In the projects that we would support as alliances, it may well be that other forms of procurement create high risks in terms of the sorts of outcomes you are wanting to achieve.

Ms PENNICUIK — Chair, can I ask one follow-up question to that?

The CHAIR — Quickly — you will get a reputation!

Ms PENNICUIK — It sort of fits in, because, Mr Fitzgerald, you were mentioning independent analysis and you were saying you were doing a review of alliances and your alliance guidelines. Is that taking into account all alliances? You are going to review the alliance guidelines by looking at the alliance projects. Is there some independent aspect to that? Is it just being done by DTF?

Mr FITZGERALD — No, we will have advisers we are engaging to work on this, so there is predominantly an engineering advisory firm that is helping us work through this, who have experience in alliancing and are very experienced in costing projects et cetera — so very technical expertise. We are also engaging with Melbourne University, so it will participate in this study as well. Remember that we do have other states involved. In terms of the projects that will be reviewed, there will be a selection; we cannot possibly review them all across Australia because it would take us 10 years to get through it. So there is a selection of projects. There is a sample of eight nationally across different sectors with different characteristics, so we can get a good understanding of the different approaches being taken.

Ms PENNICUIK — Can you tell us which eight they are or some of the clients?

The CHAIR — You might take that one on notice, I think.

Ms PENNICUIK — On notice.

Ms HUPPERT — You talked before in your response to the questions about the Gateway process, in particular the Gateway 6 review, the fact that the Gateway 6 review for the TCI is proposed to be held in July 2009. Is this appropriate timing, given that the project will have been completed about 18 months prior to that, December 2007?

Mr FITZGERALD — It is not inappropriate.

Mr DALLA-RIVA — Good answer. Next question?

Ms HUPPERT — What sort of factors need to be taken into account in the timing of these types of reviews?

Mr FITZGERALD — I do not know whether 18 months later is appropriate or inappropriate. It does seem to be a bit longer but sometimes it is worthwhile actually allowing, particularly a complex project like that, to give it some time to make sure it is actually operating properly. You might have done this six months or so, because if there is reason for probably taking a little longer than you might otherwise believe it should, I think it is probably to test it under various traffic scenarios and through different seasons et cetera in the case of that project to make sure that from an operational perspective, it is a successful outcome. That would be my understanding of where we are at.

The CHAIR — Are there guidelines under the Gateway process for timing?

Mr FITZGERALD — I do not particularly know the answer to that. I am happy to take it on notice.

The CHAIR — Maybe you should give us a copy of the Gateway 6 guidelines.

Mr FITZGERALD — Yes, we can do that; there is no problem about that.

Mr WELLS — We can get it under FOI.

The CHAIR — Save your money.

Mr FITZGERALD — In fact it is available on the internet, if you would like to access it. Just in respect of the benchmarking of alliancing, it was pointed out to me that the scope of that review is being signed off by the Auditor-General's office as well.

Ms PENNICUIK — Thank you.

Mr RICH-PHILLIPS — Mr Fitzgerald, the Auditor-General made some comments on the assessment of the risks surrounding the transaction to cash out the concession notes, specifically the assessment of risks associated with continuing to hold the concession notes to their maturity. Is DTF aware, either directly or indirectly, of any activity, action or proposal on the part of Transurban to in any way defer the redemption of the concession notes or in any other way devalue the concession notes?

Mr FITZGERALD — We are not aware of any action by Transurban to do that.

Mr RICH-PHILLIPS — Are you aware of any action by any other party to do that?

Mr FITZGERALD — No.

Mr RICH-PHILLIPS — That was never an issue leading up to this transaction that became a factor in the mind of Treasury?

Mr FITZGERALD — No, not at all.

Mr SCOTT — I noted in the Auditor-General's report that the final cost and completion dates for the Tullamarine–Calder Interchange project was on time and within budget. We had discussions with the Auditor-General's office around the advantages of alliance projects as a methodology. I am interested in your opinion whether you consider that a factor in the fact that the project was on budget and on time?

Mr FITZGERALD — Was a factor of?

Mr SCOTT — The fact that it was successfully completed within budget and on time — —

Mr FITZGERALD — Being a?

Mr SCOTT — An alliance project.

Mr FITZGERALD — Because it was an alliance project?

Mr SCOTT — Yes.

Mr FITZGERALD — Yes, it was an alliance project. It was delivered on time and on budget. The trouble is with all these projects that we would have had to do it twice under a different procurement method to know the point. But whether the outcome was any different, so — —

The CHAIR — Do two of them.

Mr FITZGERALD — But clearly, it was a complex project in terms of traffic management. There were a lot of commercial issues around the project because it feeds traffic into the toll road. So there was a lot of complexities and they seem to be well managed through the alliance process.

The CHAIR — In your letter which was sent to us, by you actually, by the Secretary, you talked about the probity arrangements. We just had evidence from the Auditor-General earlier today where he reiterated his view in regard to probity auditors and probity advisers, that this particular function should be separate. I notice you have said that perhaps the level of probity should not be left to the head of an organisation undertaking a particular project. But you also say at the bottom of page 4 of your letter:

> … will take into account the findings of the Victorian Auditor-General's office report into transport ticketing and the recommendations of PAEC in respect of tendering guidelines.

We actually did endorse the Auditor-General's view in regard to probity auditors and probity advisers being separate positions. We also said that these guidelines should be applicable to non-government sector agencies. Can you just tell us where you are at on that?

Mr FITZGERALD — I will tell you what I can. The letter I gave you actually clearly just simply states the current policy position because that is all I can state. Yes, of course you are correct that you will endorse the Auditor-General's recommendation in terms of the separation of probity advice and audit. That is still being considered by government, so there has been work and consideration undertaken by the department, but to my knowledge it is not a decision that has been taken by government yet in terms of new policy or changed policies, so I am not in a position to say that.

The CHAIR — Sure.

Mr FITZGERALD — I do understand that it is well advanced and something is likely to come to Parliament in the not too distant future.

The CHAIR — Right. I just mentioned that the Auditor-General reiterated his views this morning, so you might just want to pass that one on.

Mr DALLA-RIVA — I have a straightforward question: was DTF made aware of any internal financial transactions or any internal loan structures carried out by or within Transurban that could have had an impact on the value or on the state's interests of the concession notes? If so, what were they and what action did DTF take?

Mr FITZGERALD — I am sorry, that is a long time ago. I will have to take that question on notice if I may, because I have not prepared. If I look at the letter that came to me, it said to me:

> This committee is now seeking specific details on the actions your department has taken, or that are under way to address the recommendations included in the Auditor-General's report.

It goes on to specifically refer to recommendations that we have talked about before — 3.1, 3.3, 3.4, 3.5, 3.9, 4.1, 4.2, 4.3 and 4.4, none of which raised the question that you have. So whilst they are in the Auditor-General's report, they are not something about which I prepared myself for this hearing.

Mr DALLA-RIVA — Maybe give some clarity. Page 4, halfway down, says there was discussion about the risk assessments and the concession note transactions. So that might give you some clarity as to what I am asking in particular.

Mr FITZGERALD — Okay.

Mr DALLA-RIVA — So it is on page 4 of the executive summary. It starts and is in relation to the comment 'the state did not conduct'. So that may give you some guidance. But I will have you take that on notice.

Mr FITZGERALD — Right.

The CHAIR — All right, if there can be a follow-up on that one.

Ms MUNT — I am still interested in procurement. I am just trying to get my mind clear on how it actually works. You mentioned that you got an adviser, Rothschild, to come and do some analysis of different projects and different methods of going ahead with those projects and funding them. The DTF also does that work, I understand, within it — is that correct?

Mr FITZGERALD — Yes.

Ms MUNT — So how do you decide how you are going to analyse a particular project? Are you going to do it for yourself? Are you going to appoint an adviser to do it? Then once that is decided, how do you then get that information together and work out what is the ultimate way, or the best way, of actually financing or going ahead with the project? I just want to get myself clear on the processes that are undertaken.

Mr FITZGERALD — Look, there are a couple of things, I think, that we think about in that process. One is the complexity of the task, and one is the size of the task.

In terms of complexity, the skill and experienced required to understand and model the risks associated with quite complex financial instruments, such as concession notes, is a very detailed and complex process. There is a question about whether at any time in the department do you have all the skills needed to undertake that sort of work and that is coupled with a judgement about whether you actually have the resources to and capacity to do it. It depends on what else is on at the time. We have limited resources, we have a lot of work to do and it is not uncommon for the department, like any other department, to engage expert advisers on any such matters. Often it is engineering matters or health services. They are the two things that I guess we consider when considering. Then we go through a process where best you consider those skills. Again they are very broad. In this case, if you think about the concession notes, they are a market instrument, so they are traded or can be traded on the market. Sometimes these sort of technical skills you might want might sit in an accounting firm. But accounting firms do not trade market financial instruments. So you might engage an investment banking-type organisation on occasions, which understands how the markets value instruments like this, rather than the pure theoretical or discounted cash-flow approach to the value of an asset.

Ms MUNT — So that independent advice would then come back to DTF and then you would analyse that advice in relation to VicRoads or whoever, and then make a decision on that information that has been provided?

Mr FITZGERALD — Yes. And you would test. Typically you get this advice back and you would certainly test a lot of the assumptions. You would test the methodology that was used. We often find that we are better using those skills we have in the department to test and analyse the work of others, which gives you a more robust outcome, I believe, than doing all the work yourself. You actually have two parties that are debating the methodology, debating the assumptions, debating the issues. It often gives you a better outcome.

Mr WELLS — Mine is a follow-up question to Janice's question. The Auditor-General's report says:

> In relation to the TCI project, we concluded that there was no evidence of detailed consideration of funding sources other than the encashment of concession notes.

Why did the Department of Treasury and Finance take that option?

Mr FITZGERALD — It is related to your earlier question, I think. The alternative funding mechanism — it was the government paying for it directly out of budget surpluses. I am not sure what analysis you do because on the one hand you are actually assessing the value of an asset that you are selling, effectively, to raise the capital; on the other hand, you are simply providing cash out of budget surpluses out of the following four years, or whatever it might be. So I think there is very little basis for comparison.

Mr WELLS — But the Auditor-General said that you did not undertake a detailed consideration of other funding sources. Why was it that you went with only the encashment of concession notes?

Mr FITZGERALD — I would have to take on notice what our response to that was, unless someone can point it out to me. I can only say that we would not have agreed with the Auditor-General that there were alternative funding sources, other than funding through budget surpluses. He said we did not do it. I guess I am saying that there were not other funding sources, other than budget surpluses.

Mr WELLS — No, that is not the point. What the Auditor-General is claiming is that you did not consider other options. In your earlier answer to me, you said that they could go out to the market to borrow. That was one of the options that you suggested. What the Auditor-General is saying is that you did not consider going out to the general market to borrow or debt financing. The only option that you took in detail was the encashment of concession notes. The question is: why did you take that singular option?

The CHAIR — You can take it on notice, but I should point out that the response by the Secretary is to say — whether there is agreement between the Auditor-General and the Secretary is obviously a moot point — that:

> A number of funding alternatives were considered and analysed in depth for the M1 project.

The Secretary goes on to say that:

> The Treasury Corporation of Victoria was engaged to prepare detailed analysis of possible alternative debt-financing strategies (for example, the securitisation option).

Mr WELLS — Hang on. The question was in regard to the TCI project. With respect, Chair, it was in regard to the TCI project. You are referring to the M1 project. They are two different projects.

In fairness, if we could have a response back to the Committee: considering the time, why do we not do it that way?

Mr FITZGERALD — I am happy to do that.

The CHAIR — We will take it on notice.

Mr NOONAN — It is probably a nice way to end, in terms of the *Project Alliancing Practitioners' Guide*, you talked about a review process. I would like to understand what process DTF adopt to review the guidelines such as this, who is involved in that review and, without pre-empting what you might find as a result of that review, what perhaps critical areas might come under consideration or greatest consideration in terms of a review in this area.

Mr FITZGERALD — Those that are involved, I have mentioned the advisers who will be working for us — the University of Melbourne, who, by the way, have undertaken some benchmarking studies of public-private partnerships and traditional procurement, so they are very well experienced in this area. Regarding the eight projects that will be reviewed, that will not be a desktop review of their documentation only; as well as that, it will involve interviews with various project directors and those involved in their projects. They will all be included, both at a state and national level. This project will take six months, going through to August, so there will be a lot of interaction with various parties. There will be interaction with industry as well. We will be talking to construction companies and others whom we find on the other side of the alliance, and through the Australian alliance association as well, which represents the market participants. So it will be very broad; we will try to make it an all-encompassing review. The objective is to assess whether alliancing provides value for money for taxpayers, when alliances are best used, in what sorts of circumstances, in what sorts of projects, in what sorts of project complexities, et cetera. But the ultimate objective will be to improve value-for-money outcomes.

The CHAIR — Thank you very much for your evidence. I need to formally say that concludes consideration of funding and delivery of two freeway upgrade projects. I thank you, Mr Fitzgerald, Mr Loos and Ms Opie, for your attendance today. The Committee will follow up with you in writing at a later date the questions that have been taken on notice, and it requests that a written response to those matters be provided within 30 days.

Witnesses withdrew.