



Auditor-General for Australia



14 January 2016

The Hon Catherine King MP
Shadow Minister for Health
PO Box 6022
Parliament House
CANBERRA ACT 2600

Dear Ms King

Palmerston Hospital—milestone payment

I am writing in response to your letter of 22 October 2015 requesting that I consider undertaking a performance audit into the administration of the Project Agreement for the Health and Hospitals Fund—2010 Regional Priority Round Project in Palmerston (the Agreement). The Agreement relates to the development of the new Palmerston Hospital in the Northern Territory.

I do not plan to undertake a performance audit of this matter, as the then Department of Health and Ageing's administration of the Health and Hospitals Fund (HHF) was reviewed in depth in a performance audit report tabled in June 2012. However, following receipt of your letter I asked my staff to obtain information from the Commonwealth Department of Health (Health) about the administration of the Agreement, and in particular the payment of \$35 million in September 2015 against milestone number three relating to 'commence construction'.

The information received from Health indicates that the Northern Territory first sought payment against milestone three in May 2015. The request was declined by Health on the basis that the trigger for the achievement and associated payment of the 'commence construction' milestone was 'at the very least, the appointment of a Managing Contractor and possession of the site'.

Health subsequently sought and received additional information from the Northern Territory on the status of the project, which demonstrated that a managing contractor was appointed in July 2015. Health was also advised that the managing contractor had free access to the site pending formal occupation in late September 2015, and would assume design responsibility on 14 September 2015. On the basis of advice received from the Northern Territory, and the adoption of a risk-based approach, Health decided on 8 September 2015 to make the payment for milestone three.

Background

The Agreement

The purpose of the Agreement is to support the delivery of the Australian Government's Health and Hospitals Fund 2010 Regional Priority Project in Palmerston, through the construction of the new Palmerston Hospital.

The Agreement was signed by the Commonwealth Minister for Health on 4 June 2014 and the Northern Territory Minister for Health on 13 August 2014. It replaced an earlier Agreement dated 28 May 2012, and will expire on 30 June 2018 or on completion of the project as outlined in the Project Plan.

Under the Agreement, the Commonwealth will provide a financial contribution to the Northern Territory of \$110 million—\$70 million from the Health and Hospitals Fund and \$40 million from other sources—and the Northern Territory will contribute \$40 million to the project. All payments are GST exclusive.

Table 1 of the Agreement contains a summary of payment milestones and reporting arrangements for Commonwealth payments totalling \$110 million. Paragraph 14 of the Agreement provides that the Project Plan is expected to be a flexible document that may be varied over time to accommodate changed circumstances. Paragraph 14 also provides that variations to the Project Plan that directly affect payment milestones and their achievement require written agreement between senior Commonwealth and Northern Territory officials.

Milestone three (commence construction)

The Agreement documents that milestone three is 'commence construction'. The 'date due' (payment milestone) is recorded as May 2015, as is the relevant reporting date. The milestone payment is \$35 million.

Health received a project status report from the Northern Territory Department of Health (NT Health) on 15 May 2015. In its assessment of the May report, Health concluded that the report did not demonstrate the achievement of the 'commence construction' milestone at the site. Health observed that:

- The commencement of site services and the release of a managing contractor tender on 5 May 2015 did not provide sufficient evidence to support the milestone three payment. However, this activity demonstrated good progress for milestone two 'site services commenced', for which NT Health had already received a \$20 million payment.
- "As is our regular practice ... the trigger for the achievement and associated payment of the 'Commence Construction' milestone is, at the very least, the appointment of a Managing Contractor and possession of the site."

On 5 August 2015 Health received the following additional information from the Northern Territory Department of Infrastructure's project director in support of milestone payment three:

- Lend Lease was appointed as the managing contractor in July 2015. Relevant correspondence (dated 22 July 2015) between the Northern Territory and Lend Lease was provided to evidence the appointment. Project planning sheets (Gantt charts) prepared by Lend Lease were also submitted to Health.

- A summary of the status of projects under the head works program (relating to water mains, road access, storm water works, sewers and high voltage works). To evidence key aspects of this work, site images (colour photographs) were provided of road works, site clearing and remediation, and the main water works.
- Detailed floor plans and room data sheets were submitted to evidence design work.

Health records indicate that the department subsequently requested confirmation from the Northern Territory (the Department of Infrastructure's project director) as to when Lend Lease was expected to take possession of the site. This approach reflected Health's position that the trigger for the achievement and associated payment of the commence construction milestone was the appointment of a managing contractor and possession of the site.

The Northern Territory's project director advised on 7 August 2015 that:

- Lend Lease was not in a position to formally occupy the site until late September 2015 when the site subdivision was finalised. However, temporary occupancy approval had been issued for the headworks, remediation works, soil testing and general surveying for structural and service design requirements. Lend Lease had free access to attend the site under this arrangement and had been on site on several occasions since its appointment.
- Lend Lease was involved with the design progress and was an active participant with relevant Darwin based architects and engineers to finalise early works tender packages. In addition, NT Health advised Health that novation of the design contract to Lend Lease (ie. transfer of design responsibility) was expected to occur on 14 September 2015.

Payment against milestone three

Health provided written advice to an internal delegate on 7 September 2015 recommending that the delegate approve the payment of \$35 million (GST exclusive) for milestone three, on the basis of the documentation provided by the Northern Territory.

In particular, the advice referenced: the appointment of a respected managing contractor for the project; the interim site access arrangements pending formal occupation of the site by Lend Lease; and the anticipated transfer of design responsibility to Lend Lease. The advice summary observed that:

A highly risk averse approach may perhaps consider that the payment should be made after the point at which the managing contractor had both formally gained access to the site and responsibility for the project's design. However, our understanding is that the Commonwealth is moving to a less intensive approach to managing state and territory projects—as illustrated by the Prime Minister halving reporting frequency to twice yearly. Also, our approach to these projects is shaped by the principle that we take a risk based approach, and therefore, in view of Lend Leases's expertise and track record and the considerable activity at the site, I am of the view that this *Commence Construction* milestone can now be deemed to have been met.

The delegate approved the milestone payment on 8 September 2015.

Previous performance audit

Performance Audit Report No. 45 2011-12 *Administration of the Health and Hospitals Fund*, was presented for tabling on 20 June 2012. The audit examined the first three HHF funding rounds announced in May 2009, early 2010 and May 2011.

I trust this information is of assistance.

Yours sincerely

A handwritten signature in black ink, appearing to read 'G. Hehir', with a long horizontal flourish extending to the right.

Grant Hehir
Auditor-General