

The Auditor-General  
Audit Report No.52 2005–06  
Performance Audit

**Management of selected Telstra Social Bonus 2 and  
Telecommunications Service Inquiry Response Programs**

**Department of Communications, Information  
Technology and the Arts**

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of Australia 2006

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Canberra ACT  
29 June 2006

Dear Mr President  
Dear Mr Speaker

The Australian National Audit Office has undertaken a performance audit in the Department of Communications, Information Technology and the Arts in accordance with the authority contained in the *Auditor-General Act 1997*. Pursuant to Senate Standing Order 166 relating to the presentation of documents when the Senate is not sitting, I present the report of this audit and the accompanying brochure. The report is titled *Management of selected Telstra Social Bonus 2 and Telecommunications Service Inquiry Response Programs*.

Following its presentation and receipt, the report will be placed on the Australian National Audit Office's Homepage—<http://www.anao.gov.au>.

Yours sincerely



Ian McPhee  
Auditor-General

The Honourable the President of the Senate  
The Honourable the Speaker of the House of Representatives  
Parliament House  
Canberra ACT

## AUDITING FOR AUSTRALIA

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# Abbreviations/Glossary

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ANAO	Australian National Audit Office
ANP	Advanced Networks Program
ANP2	Advanced Networks Program 2
BAA2	Backing Australia's Ability 2 package of programs
BITS	Building on Information Technology Strengths
CDMA	Code Division Multiple Access (one of the two common terrestrial mobile phone technology platforms)
DCITA	Department of Communications, Information Technology and the Arts
exits	divestments of the equity investments made by incubators in incubatees, which can also include incubatee liquidations
graduate	an incubatee who has completed their period of incubation by meeting the milestones set out in their agreement with the incubator
GSM	Global systems for mobiles (one of the two common terrestrial mobile phone technology platforms)
GST	goods and services tax
ICT	information and communications technology
incubatee	a start-up company accepted into incubation by incubators funded under the BITS and ICT Incubators Programs, usually by way of the incubator taking an equity stake in the start-up company
ISDN	Integrated Services Digital Network
IT	information technology

KPIs	key performance indicators
Minister	Minister for Communications, Information Technology and the Arts
MOUs	memoranda of understanding
NCF	National Communications Fund
NTN	Networking the Nation
programs subject to audit	the BITS Incubator, ICT Incubators, ANP, ANP2, Intelligent Island, NCF and Towns over 500 programs
RFT	request for tender
TAPRIC	Telecommunications Action Plan for Remote Indigenous Communities
TSB2	Telstra Social Bonus 2 package of programs
TSI Response	Telecommunications Service Inquiry Response package of programs

# **Summary and Recommendations**



# Summary

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## Background

1. In June 1999 and May 2001, the Government announced the Telstra Social Bonus 2 (TSB2) and Telecommunications Service Inquiry Response (TSI Response) funding packages, respectively. These packages, totalling over \$830 million, are designed to enhance telecommunications infrastructure development and service availability across Australia, and address associated inequities in regional, rural and remote areas compared with capital cities.
2. All 20 programs under the TSB2 and TSI Response packages are administered by the Department of Communications, Information Technology and the Arts (DCITA). As at March 2006, most of the programs have been completed or are nearing completion.
3. The audit objectives were to examine the extent to which selected TSB2 and TSI Response programs:
  - are achieving or had achieved their objectives; and
  - had been administered effectively by DCITA according to better practice principles. To evaluate this aspect, the audit assessed DCITA's compliance with the better practice principles outlined in the *Administration of Grants Better Practice Guide* (May 2002) produced by the Australian National Audit Office (ANAO). There are 19 separate principles covered under the broad areas of:
    - Planning for effective grant programs;
    - Selecting projects;
    - Managing and monitoring funding deeds; and
    - Evaluating and reporting grant program performance.
4. The ANAO examined the following programs (the 'programs subject to audit'):
  - Building on Information Technology Strengths (BITS) Incubator Program;
  - BITS Advanced Networks Program (ANP);
  - BITS Intelligent Island Program;

- National Communications Fund (NCF) Program;
- Towns over 500 Program;
- Information and Communications Technology (ICT) Incubators Program; and
- Advanced Networks Program 2 (ANP2).

5. Two of the programs subject to audit from the TSB2 package, *BITS Incubator* and *ANP*, were, in effect, extended by two new programs, *ICT Incubators* and *ANP2* respectively. These were funded from the Backing Australia's Ability 2 package of programs announced in June 2004.

6. The delivery mechanisms for the programs subject to audit varied from contracts with telephony providers, to grants through or to consortia of private or (state) public sector organisations.

7. The better practice principles for grant management serve as a guide to agencies to help them to administer their grant programs efficiently, effectively and equitably. The ANAO considers that compliance with the principles will lead to sound grant management practice. However, there may be occasions where agencies consider that relevant principles should not be applied to their grant programs for various reasons including the existence of adequate compensatory management controls. In these cases, the ANAO considers that the transparency of agencies' grant management would be well served if they formally documented the reasons for partially complying or not complying with the relevant principles of better practice.

## Overall audit conclusion

8. The ANAO considers that all programs subject to audit, except one, are effectively achieving their stated objectives. Significant delays to the *Intelligent Island Program* have resulted from a number of outstanding issues that will need to be resolved before the program could be considered to be on track to achieve its objectives.

9. The ANAO considers that the ICT Division of DCITA, where the programs subject to audit have been managed, demonstrated a high degree of understanding of the principles of better grant management practice. The ANAO commends DCITA's attempt to further reinforce sound grant management practice within the department through its recently-produced *Practical Guide to Program Management*.

10. The ANAO concluded that DCITA's management of the seven programs subject to audit demonstrated a high level of compliance with the better practice principles of grant management. Overall, DCITA planned the programs subject to audit well, selected the best projects to fund, and managed the projects well given their complexity. The program mid-term reviews and evaluations undertaken were well established and measured the programs' performance against their respective objectives.

11. Notwithstanding this, the ANAO considers there are certain areas of DCITA's grant management practice, impacting more than one audited program, that only partially complied with relevant better practice principles. In this regard, processes could be improved in areas of:

- applying formal risk management methods to program management (affecting all programs subject to audit, except *NCF*);
- establishing performance indicators early in the life of some programs that comprehensively measure and link the programs' performance against their respective objectives (*BITS Incubator*, *ANP*, *ANP2* and *Intelligent Island* programs);
- reporting program performance against all of the programs' respective objectives or key performance indicators (all programs subject to audit, except *Towns over 500*); and
- ensuring that independent acquittals of grant funds are always received in a timely manner (*Intelligent Island* and *NCF* programs).

12. The ANAO concluded that processes surrounding the calling for, and assessment of, submissions to extend existing projects under the *ICT Incubators* and *ANP2 programs* were not as rigorous as for their preceding programs. This resulted in some partial compliance or non-compliance with better practice principles in respect of:

- guidance provided to applicants (affecting *ICT Incubators* and *ANP2* programs);
- DCITA's appraisal of the submissions (*ANP2*); and
- maximising the programs' value for money (*ICT Incubators* and *ANP2* programs).

13. The ANAO concluded that, although the performance monitoring regime for the *Intelligent Island Program* was well established, DCITA has not

monitored the achievement of the program's objectives using the agreed performance measures. This does not represent sound grant management practice. The ANAO also considers that DCITA could have taken earlier action to progress the *Intelligent Island Program*, which has experienced significant delays throughout its life.

14. The ANAO's assessment of DCITA's compliance against the 19 grant management principles for each program subject to audit is summarised in Table 1 below.

15. The ANAO made two recommendations aimed at enhancing DCITA's administration of grant programs.

## DCITA response

16. The Department welcomes the ANAO findings that its management of all audited programs demonstrated a high level of compliance and understanding of the better practice principles of grants management and that the Department has a disciplined process for budgeting and running costs which allocates resources efficiently and effectively. The Department also welcomes the ANAO's finding that programs subjected to audit are effectively achieving their objectives.

17. In regard to Recommendation 1, the Department notes that the decision about appropriate processes for extending programs will need to take into account any relevant assessments made in the review process of the original programs. The Department also notes that the issues of submission quality may not always arise because, for example, the program is not submissions-based or because the program has generated submissions of adequate quality in the past. As outlined in paragraphs 2.35 and 2.45 of the Report, the Department considers that, for the ICT Incubators Program and ANP2, the processes for extending were appropriate given the particular circumstances for these programs.

18. The Department agrees with a proactive approach to the management of risks and has developed a comprehensive and contemporary risk management framework. In regard to Recommendation 2, the Department agrees, while noting that other whole of government considerations may be relevant to the approach to be adopted.

**Table 1****Summary of DCITA's compliance against the better practice principles of grant management**

Criteria	BITS Incubator	ICT Incubators	ANP	ANP2	BITS Intelligent Island	NCF	Towns over 500
<b>Planning for Effective Grant Programs (Chapter 2)</b>							
Establishing the need for the program	✓✓	✓✓	✓✓	✓✓	✓✓	✓✓	✓✓
Defining operational program objectives	✓✓	✓✓	✓✓	✓✓	✓✓	✓✓	✓✓
Program risk management	✓	✓	✓	✓	✓	✓✓	✓
Designing programs for value for money	✓✓	✓	✓✓	✗	✓✓	✓✓	✓✓
Designing programs for accountability	✓✓	✓✓	✓✓	✓✓	✓✓	✓✓	✓✓
Establishing performance measures	✓	✓✓	✓	✓	✓	✓✓	✓✓
Selecting funding strategies	✓✓	✓✓	✓✓	✓✓	✓✓	✓✓	✓✓
Considering taxation issues	✓✓	✓✓	✓✓	✓✓	✓✓	✓✓	✓✓
Producing program guidelines	✓✓	✓	✓✓	✗	✓✓	✓✓	✓✓
<b>Selecting Projects (Chapter 3)</b>							
Handling applications	✓✓	✓✓	✓✓	✓	na	✓✓	✓✓
Appraising applications	✓✓	✓✓	✓✓	✗	na	✓✓	✓✓
Making grant announcements	✓✓	✓✓	✓✓	✓✓	na	✓✓	✓✓
<b>Managing and Monitoring Funding Deeds (Chapter 4)</b>							
Establishing funding deeds	✓✓	✓	✓✓	✓	✓✓	✓✓	✓✓
Establishing monitoring arrangements	✓✓	✓✓	✓✓	✓✓	✓	✓✓	✓✓
Monitoring progress and payments	✓	✓✓	✓✓	✓✓	✗	✓✓	✓✓
Acquitting funds	✓✓	✓✓	✓✓	✓✓	✓	✓	✓✓
<b>Evaluating and Reporting Grant Program Performance (Chapter 5)</b>							
Managing the program reviews	✓✓	✓✓	✓✓	✓✓	na	✓✓	na
Carrying out the program reviews	✓	✓✓	✓✓	✓✓	na	✓✓	na
Reporting the programs' performance	✓	✓	✓	✓	✓	✓	✓✓

Source: ANAO analysis

- ✓✓ complies with better practice principle in all material respects
- ✓ partially complies with better practice principle, but with some room for improvement
- ✗ does not comply with better practice principle, with significant shortcomings
- na not applicable

## Key Findings

### Planning for effective grant programs (Chapter 2)

19. The ANAO found that for all programs subject to audit DCITA had adopted sound practices with respect to:

- Determining the need for the programs or the areas to be targeted by the programs—using appropriate combinations of interdepartmental committees, scoping consultancies and consultations with program stakeholders;
- Defining operational program objectives—in terms of measurable outcomes;
- Designing the programs for accountability—during the selection process, and ongoing management and monitoring of the projects and programs;
- Selecting funding strategies—by adequately considering the risks and benefits of alternative funding strategies and by adequately considering cash management principles when establishing payment profiles for each grant and grant program; and
- Considering taxation issues—by, primarily, informing potential applicants through program guidelines how the goods and services tax applied to the programs and that successful applicants would be responsible to the Australian Taxation Office for any taxation requirements.

20. For the majority of programs subject to audit, DCITA's program risk management only partially complied with better practice principles. Although DCITA satisfactorily managed most of the risks applicable to the programs subject to audit, improved formal risk management practices would provide greater assurance that all significant risks to programs have been identified and mitigation strategies put in place.

21. The ANAO considers that the administrative controls for the *BITS Incubator*, *ANP*, *Intelligent Island*, *NCF* and *Towns over 500* programs, as implemented and exercised by DCITA, provide assurance that DCITA complied with the better practice principle of maximising their value for money. However, greater leverage may have been achieved from grant funding in the *ICT Incubators* and *ANP2* programs.

22. The ANAO considers that the competitiveness of the selection process for the *ICT Incubators Program* was adversely affected by DCITA notifying BITS incubators in advance of the possible post-selection outcomes in the program guidelines. This led to DCITA's assessment that some incubators did not make an obvious effort to prepare high quality submissions—including incubators selected by DCITA. Increased competition may have led incubator owners to propose greater contributions of cash and in-kind outgoings from themselves for their incubatees. In addition, when establishing funding deeds, DCITA set low standardised performance targets that did not present a challenge to most ICT incubators. The risk with setting performance targets too low is that, once achieved, grantees will not make every effort to maximise their performance.

23. The ANAO also considers that had ANP grantees provided more structured ANP2 submissions (based on additional guidance from DCITA), DCITA could have assessed more thoroughly the relative merits, and therefore the value for money, of each grantee's submission. In addition, there was no documentation on file evidencing DCITA's assessment of these submissions. As grantees were asked for submissions, it could reasonably be expected that DCITA would assess their relative merits, in conjunction with grantees' performance to date. This assessment would have improved the advice provided to the Minister for Communications, Information Technology and the Arts for funding the grantees.

24. The performance measurement and monitoring strategies for the *ICT Incubators*, *NCF* and *Towns over 500* programs complied with better practice principles. The performance indicators of the remaining programs subject to audit only partially complied with better practice principles as they did not comprehensively measure and link the programs' performance against their respective objectives early in the lives of the programs.

25. At the time of the calls for proposals or tenders, DCITA developed sound program guidelines or equivalents for all programs subject to audit except *ICT Incubators* and ANP2. The ANAO assessed program guidelines for the *ICT Incubators* and ANP2 programs as partially compliant and non-compliant with better practice principles, respectively, for the reasons noted above.

## Selecting projects (Chapter 3)<sup>1</sup>

26. The ANAO found that for all programs subject to audit, except *ANP2*, DCITA had complied with better practice principles in respect of:

- handling and appraising project applications and tenders consistently and fairly; and
- documenting decisions, and reasons for decisions.

27. As noted above, the ANAO considers that greater guidance to ANP grantees would have improved the quality of their submissions for further funding under *ANP2*. In addition, there was insufficient documentation available to enable the ANAO to assess the quality of DCITA's appraisal of *ANP2* submissions.

28. For all programs subject to audit, DCITA adopted sound practice by:

- making grant or contract offers to successful applicants and the successful tenderer; and
- advising unsuccessful applicants and the unsuccessful tenderer;

within reasonable times of selection decisions.

## Managing and monitoring funding deeds (Chapter 4)

29. Given the complexity of the projects funded, DCITA established funding deeds, MOUs or a contract under the *BITS Incubator*, *ANP*, *Intelligent Island*, *NCF*, and *Towns over 500* programs in compliance with better practice principles. Nevertheless, the ANAO considers that the process for establishing funding deeds for complex or high risk operations could be improved if DCITA:

- formally assessed the benefits of obtaining internal or external technical advice during deed negotiations on a case-by-case basis;
- set and formally updated deed negotiation timetables to urge grant recipients to finalise negotiations in a timely manner; and

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<sup>1</sup> As the scope of the audit did not extend to examining the merits of decisions taken by the Intelligent Island Board or Project Executive to fund particular projects, the better practice criteria for selecting projects are not applicable to the *Intelligent Island Program*.

- required each grantee to develop a risk management plan at the start of their project and to regularly monitor and report on the management of the project's risks.

30. The sustainability (or ongoing financial viability) of the funded projects after the conclusion of grant programs was a feature of all the programs subject to audit, except *Intelligent Island*. The ANAO found that project sustainability was handled well in the funding deeds for the *ANP2*, *NCF* and *Towns over 500* programs, but not as well in the funding deeds for the *BITS Incubator*, *ICT Incubators* and *ANP* programs. Project sustainability under the *ICT Incubators Program* is particularly important as it formed part of the justification for the program extension and was a program objective. Nevertheless, the ANAO recognises the experimental nature of the *BITS Incubator* and *ICT Incubators* programs meant that some of the incubator business models would be successful while others could encounter difficulties in becoming self-sustainable. The ANAO considers that had project sustainability received a higher profile, DCITA could have asked grantees to nominate sustainability measures and targets they considered appropriate. Incorporating these into the deeds does not guarantee their achievement or the longer-term viability of the incubators. However, they do provide benchmarks against which the grantees would formally and regularly report their progress on to DCITA.

31. The ANAO considers that the quality of funding deeds under the *ICT Incubators* and *ANP2* programs could have been improved had DCITA:

- tailored challenging but achievable performance targets for each ICT incubator rather than using standardised targets;
- better taken into account measures to aid the ICT incubators along the path to longer-term self-sustainability; and
- documented its critical assessment of the *ANP* grantees' submissions for further funding under *ANP2*.

32. DCITA established strategies to monitor the performance of the projects of all programs subject to audit, except *Intelligent Island*, in compliance with better practice principles. The ANAO considers that the monitoring framework for the *Intelligent Island Program* will be enhanced once its planned procedures manual is developed.

33. The ANAO considers that DCITA monitored grantees' performance against the funding deed, MOU or contract requirements according to sound

practice for all programs subject to audit, except *BITS Incubator* and *Intelligent Island*. The ANAO questions the timeliness of, and justification for, varying one *BITS Incubator* funding deed that waived the injection of previously agreed payments from its consortium members. Although the performance monitoring regime for the *Intelligent Island Program* was well established, DCITA has not monitored the achievement of the program's objectives using the agreed performance measures. This does not represent sound grant management practice.

34. The ANAO considers that all programs subject to audit, except the *Intelligent Island Program*, are effectively achieving their stated objectives. Significant delays to the *Intelligent Island Program* have resulted from a number of outstanding issues that will need to be resolved before the program could be considered to be on track to achieve its objectives. DCITA could have also taken earlier action to progress the *Intelligent Island Program*.

35. Audited financial reports are a key control mechanism to ensure Australian Government funding is spent on the projects to which it was allocated. The ANAO considers that DCITA acquitted the funding for the *BITS Incubator*, *ICT Incubators*, *ANP*, *ANP2* and *Towns over 500* programs in compliance with better practice principles. However, DCITA did not receive independent acquittals for *Intelligent Island* funding and funding for one of the eight *NCF* projects when they fell due. Where significant amounts of funding have been disbursed, such as the case with the *Intelligent Island Program* and the *NCF* project referred to above, DCITA should require the grantees to provide audited financial reports in a timely manner.

## **Evaluating and reporting grant program performance (Chapter 5)**

36. The ANAO considers that DCITA established the requirements for mid-term reviews and evaluations, and final reports from grantees for all relevant programs subject to audit, in accordance with sound practices.

37. The mid-term reviews or evaluations complied with better practice principles as they measured the performance of the projects and the programs against the programs' stated objectives. The ANAO also considers that the reviews and evaluations provided a reasonable encapsulation of the performance of the respective programs and funded projects at the time the reviews and evaluations were conducted. Final project reports, when received, have helped measure the programs' performance against their objectives and key performance indicators. However, the ANAO notes there is a risk that

DCITA will not receive final project reports from the two BITS incubators that received no further government funding.

38. The ANAO considers that DCITA's annual reporting for most programs subject to audit would be enhanced if DCITA placed greater emphasis on regularly measuring and reporting publicly the programs' performance against their objectives. Reporting of the performance of the *Towns over 500 Program* complied with better practice principles.

# Recommendations

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**Recommendation  
No.1  
Para 2.48**

The ANAO recommends that when DCITA considers providing further funding to existing programs or projects, DCITA:

- (a) develops program guidelines and communication strategies to improve the quality of submissions; and
- (b) documents its assessment of the relative merit of the submissions.

*Agency Response:* DCITA agrees.

**Recommendation  
No.2  
Para 4.21**

The ANAO recommends that DCITA require grantees who receive grants for complex or high risk operations to:

- (a) develop a risk management plan at the start of the grant;
- (b) regularly and formally monitor and manage the project's risks; and
- (c) report regularly to DCITA (at least on an exceptions basis) on the project's management of identified higher priority risks.

*Agency Response:* DCITA agrees.

## **Audit Findings and Conclusions**



# 1. Introduction

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*This chapter introduces the details of packages of government programs aimed at Australia's information and communications technology sector, particularly in rural, regional and remote Australia. It outlines the programs selected for the audit, the audit objectives, scope, approach and conduct. It concludes with an outline of the structure of the report.*

## Background and context

**1.1** In June 1999, the Government provided \$670 million for a range of new programs funded from the proceeds of the sale of the second tranche of Telstra, known as the Telstra Social Bonus 2 (or TSB2) package of programs. The 12 programs range in size from \$3 million to \$158 million, to be disbursed over a number of years.

**1.2** In May 2001, the Government announced a funding package of \$163.1 million in response to the recommendations of the Telecommunications Service Inquiry (the Besley Report), known as the TSI Response package of programs. There are seven major programs ranging in size from a small research program of less than \$1 million, to \$50 million for the National Communications Fund. Table 1.1 and Table 1.2 list the programs under the TSB2 and TSI Response suites of programs. The programs examined in this audit (the 'programs subject to audit') have been highlighted.

**1.3** As at March 2006, most of the programs have been completed or are nearing completion. However, two of the programs subject to audit have, in effect, been extended with an injection of extra funding from the Backing Australia's Ability 2 (BAA2) package announced in June 2004 (see Table 1.3).

**1.4** The TSB2 and TSI Response programs are directed at promoting and improving a more open and competitive information and communications technology (ICT) sector. Their broad objectives are to enhance telecommunications infrastructure development and service availability across Australia, and address the associated inequities in regional, rural and remote areas compared with capital cities.

**1.5** All 19 programs under TSB2 and TSI Response packages are administered by the Department of Communications, Information Technology and the Arts (DCITA) (although one of the programs was administered by the National Office for the Information Economy, which was later subsumed into

DCITA). Program delivery mechanisms vary between programs, from contracts with telephony or internet service providers, and grants through or to consortia of private or (state) public sector organisations. The programs subject to audit reflect the full range of the varying delivery mechanisms.

**1.6** The original and current funding allocations for the TSB2 and TSI Response programs are set out in Table 1.1 and Table 1.2.

**Table 1.1**

**Telstra Social Bonus 2 programs**

Program <sup>a</sup>	Original Funding \$ million <sup>b</sup>	Current Funding \$ million <sup>b</sup>
Building Additional Regional Networks (BARN)— <i>part of NTN</i>	67.3	31.7
Local Government Fund— <i>part of NTN</i>	43.3	43.3
Extending mobile phone coverage in SA, Tas and WA— <i>part of NTN</i>	3.0	3.0
Remote and Isolated Islands Fund- <i>part of NTN</i>	19.3	19.3
Internet Access Fund— <i>part of NTN</i>	33.0	3.1
Connecting Tasmanian Schools	15.0	15.0
Launceston Broadband Project	14.7	14.7
Trails of Innovative Government Electronic Regional Services (Tigers)— <i>administered by the former NOIE</i>	10.0	10.0
Television Fund	116.2	112.6
Building on Information Technology Strengths (BITS) ( <i>three components</i> )	154.1	153.1
Mobile Phones along highways	24.4	24.4
Untimed Local Calls in Extended Zones program	150.0	157.5
Net Alert	3.0	3.0
<b>Total</b>	<b>653.3</b>	<b>590.7</b>

Source: ANAO

a—Shaded program was examined in this audit.

b—Excludes departmental administration costs totalling \$17.8 million notionally allocated to managing the programs.

**Table 1.2****Telecommunications Service Inquiry Response programs**

Program <sup>a</sup>	Original Funding \$ million <sup>b</sup>	Current Funding \$ million <sup>b</sup>
Regional Mobile Phone ( <i>four components</i> )	49.9	49.1
Internet Assistance	10.8	8.8
Telecommunications consumer representation and research	3.2	3.2
Community Information Campaign	6.9	5.3
Study of telecommunication needs of remote indigenous communities	0.4	0.4
National Communications Fund (NCF)	50.0	50.0
Towns over 500	36.8	22.8
<b>TOTAL</b>	<b>158.0</b>	<b>139.6</b>

Source: ANAO

a—Shaded programs were examined in this audit.

b—Excludes departmental administration costs totalling \$5.9 million notionally allocated to managing the programs.

1.7 The original and current funding of the two programs examined in the audit arising out of the broader BAA2 package are listed in Table 1.3.

**Table 1.3****Selected Backing Australia's Ability 2 programs**

Program	Original Funding \$ million <sup>a</sup>	Current Funding \$ million <sup>a</sup>
Information and Communication Technology (ICT) Incubators Program— <i>extension of BITS Incubator Program</i>	34.1	34.1
Advanced Networks Program 2 (ANP2)— <i>extension of BITS ANP</i>	20.0	20.0

Source: ANAO

a—Excludes departmental administration costs totalling \$2.8 million notionally allocated to managing the programs.

## Program overviews

**1.8** The Building on Information Technology Strengths (BITS) program consisted of three components. The *BITS Incubator Program* provided \$76 million of Australian Government funding over five years (1999–2000 to 2003–04) to ten for-profit and not-for-profit incubators in mainland Australia to support the development of start-up companies in the ICT sector. The BITS Advanced Networks Program (ANP) provided \$37.2 million over three years (2001–02 to 2003–04) to three projects to support the development, trialling, and demonstration of advanced communications networks and test beds. The BITS *Intelligent Island Program* provided \$40 million over five years (1999–2000 to 2003–04) to or through the Tasmanian Government to promote the development of an internationally competitive ICT sector in Tasmania.

**1.9** The National Communications Fund (NCF) provided \$50 million over three years (2002–03 to 2004–05) to improve service delivery in the education and health sectors by funding eight large-scale communications projects in regional areas of Australia.

**1.10** The *Towns over 500 Program* was allocated \$37.7 million over three years (2001–02 to 2003–04). The Australian Government contracted Telstra, at a cost of approximately \$23 million, to extend terrestrial mobile phone coverage to towns with populations of 500 or more, subject to community need and ongoing viability.<sup>2</sup>

**1.11** Two of the programs subject to audit have been, in effect, extended under the BAA2 package of programs. The Australian Government provided \$34.1 million for the *ICT Incubators Program* (an extension of the *BITS Incubator Program*) for four years (2004–05 to 2007–08). Additional funding was provided to eight previously funded incubators under the *ICT Incubators Program*.<sup>3</sup> The Australian Government also provided \$20 million for the Advanced Networks Program 2 (ANP2) to continue the funding of the three projects previously funded under the ANP for a further three years (2004–05 to 2006–07).

**1.12** Table 3.1 lists all projects funded under the *BITS Incubator*, *ICT Incubators*, ANP, ANP2 and NCF programs.

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<sup>2</sup> Some of the savings were returned to the Government and the remainder was re-allocated to other programs, with Ministerial or Government approval.

<sup>3</sup> Including the incubator previously funded under the *Intelligent Island Program*.

## Program objectives

**1.13** A summary of the objectives for each of the programs subject to audit is provided in Table 1.4.

**Table 1.4**

### Summarised objectives of the programs subject to audit

Program	Summarised Objective
BITS Incubator	To assist in the development of a dynamic, globally oriented information technology and communication (IT&C) industry sector by funding incubator centres
Information and Communication Technology Incubators Program ( <i>extension of BITS Incubator</i> )	To support those incubators currently funded by the BITS program to continue playing a significant role in the national innovation system
BITS Advanced Networks Program (ANP)	To contribute to the development of advanced network infrastructure in Australia that will deliver long-term benefits to the Australian economy. In pursuit of this objective the program will support progress towards the establishment of a national advanced backbone network
Advanced Networks Program 2 (ANP2) ( <i>extension of BITS Advanced Networks Program</i> )	To preserve the value and momentum of investments already made through the program with the goal of continuing to contribute to the development of advanced network infrastructure in Australia that will deliver long-term benefits to the Australian economy
BITS Intelligent Island	To further develop an internationally competitive (information technology and telecommunications) sector in Tasmania
National Communications Fund (NCF)	To achieve significant improvements in service delivery in the education and health sectors through funding large-scale telecommunications projects in regional areas. Priority will be given to projects that improve telecommunications service generally in regional communities, as well as improving the delivery of education and health services
Towns over 500	To seek innovative and economically sustainable solutions from existing terrestrial mobile phone infrastructure providers to upgrade, and in some cases, introduce, handheld mobile phone coverage to include Designated Towns of 500 and above

Source: ANAO

## Previous audits and major evaluations

**1.14** Earlier Australian National Audit Office (ANAO) audits examined DCITA's management of the Networking the Nation (NTN) General Fund and associated TSB2 programs, where the NTN Board was responsible for the

approval of projects.<sup>4</sup> These audits were *Audit Report No.43 1998–1999 Networking the Nation—The Regional Telecommunications Infrastructure Fund* and, later, *Audit Report No.12 2003–2004 The Administration of Telecommunications Grants*.

**1.15** The major conclusions of the latter audit, as they impacted DCITA, were:

- Although DCITA's administration of the programs demonstrated elements of better practice, there was scope to improve the administration of the programs examined;
- Although departmental annual reports and other reports provide information on levels of program activity, it is difficult for stakeholders to get a sense of what outcomes have been achieved by the various programs and how they have contributed to the achievement of the government's broader policy objectives; and
- The ANAO was satisfied DCITA had implemented the three recommendations from the earlier Audit Report No.43 1998–1999.

**1.16** In October 2005, the Minister for Communications, Information Technology and the Arts (the Minister) released an evaluation of the Networking the Nation program. Although this evaluation focused on programs not examined in this audit, one part of the evaluation—concerning the administrative efficiency of the NTN program—contained recommendations applicable to other grant programs administered by DCITA. The ANAO has referred to this evaluation, where relevant, in this audit report.

## **Audit objectives and scope**

**1.17** The audit objectives were to examine the extent to which selected Telestra Social Bonus 2 (TSB2) and Telecommunication Service Inquiry (TSI) Response programs are achieving or had achieved their objectives, and have been administered effectively by DCITA. The audit objectives were to assess whether:

- DCITA is administering the planning, selection, monitoring and evaluation of the grant programs, in compliance with better practice principles; and

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<sup>4</sup> Audit Report No.12 2003–04 also examined the Rural Transaction Centres Program administered by the Department of Transport and Regional Services.

- the reporting and performance information provides sufficient transparency to meet accountability requirements of stakeholders.

**1.18** The audit examined the following programs:

- TSB2—Building on Information Technology Strengths (BITS):
  - BITS Incubator;
  - BITS Advanced Networks Program (ANP); and
  - BITS Intelligent Island;
- TSI Response—National Communications Fund (NCF);
- TSI Response—Towns over 500;
- BAA2 Package—Information and Communication Technology Incubators Program (ICT Incubators Program); and
- BAA2 Package—Advanced Networks Program 2 (ANP2).

**1.19** The audit scope was limited to the planning of the programs, selection of grantees, the monitoring of a sample of projects and program evaluation and reporting. The ANAO did not directly audit the relationship between grantees and intended final recipients (for example, State governments administering the *NCF Program* for the benefit of regional schools), and grantees and their contractors (for example, State governments engaging a telecommunications carrier to deliver services). Nevertheless, the ANAO examined the information provided to DCITA by the grantees about their activities to assist the ANAO in forming an opinion against the audit objectives.

**1.20** Although the Australian Government was represented on the Intelligent Island Board (at Ministerial and officer level) and the Project Executive (at officer level), the ANAO did not examine the merits of decisions taken by the Board or Project Executive (neither being Australian Government bodies) to fund particular projects under the *Intelligent Island* initiatives. The ANAO, nonetheless, examined the extent to which the Intelligent Island Implementation and Business Plans agreed between the Australian and Tasmanian Governments, as a whole, were being achieved.

## Audit approach and conduct

**1.21** The audit assessed DCITA's compliance with the 19 separate better practice principles outlined in the ANAO's *Administration of Grants* Better

Practice Guide (May 2002). The better practice principles for grant management serve as a guide to agencies to help them to administer their grant programs efficiently, effectively and equitably. The ANAO considers that compliance with the principles will lead to sound grant management practice. However, there may be occasions where agencies consider that relevant principles should not be applied to their grant programs for various reasons including the existence of adequate compensatory management controls. In these cases, the ANAO considers that the transparency of agencies' grant management would be well served if they formally documented the reasons for partially complying or not complying with the relevant principles of better practice.

**1.22** Two of the programs examined are not standard grant programs. The BITS Intelligent Island Program involves an allocation of funding to or through the Tasmanian Government to fund a number of information technology (IT) initiatives. The Towns over 500 Program involved a tender process to contract a service provider to deliver the program. Nevertheless, the ANAO considers many of the criteria applicable to good grant management are still applicable to these programs. Where the criteria are not relevant, the ANAO has indicated this in the report.

**1.23** The main methods of inquiry involved:

- examining DCITA's key files and records relevant to the administration of the programs, and external reports, including annual reports and program reviews or evaluations;
- interviews with DCITA officers; and
- site visits, including interviews with grantees and program beneficiaries.

**1.24** The audit was conducted in accordance with ANAO auditing standards and cost \$235 000.

## Structure of the report

**1.25** The report is based around the four key elements in the administration of grants programs:

- planning for effective grant programs (Chapter 2);
- selecting projects (Chapter 3);
- managing and monitoring funding deeds (Chapter 4); and
- evaluating and reporting grants program performance (Chapter 5).

## 2. Planning for Effective Grant Programs

*This chapter assesses DCITA’s performance in planning the grant programs subject to audit against the planning principles outlined in the ANAO’s Administration of Grants Better Practice Guide (May 2002).*

### The need for the programs

**2.1** Departments are commonly asked to develop options to implement Government policies or to advance approaches that may be adopted to deliver particular policy objectives. In these situations, departments are expected to analyse the need for the programs or the particular approaches they recommend to Government, to ensure the proposal best meets the policy objectives. Alternately, where the Government takes a specific decision to establish a program, agencies should consider whether further needs analysis would assist in targeting the areas or projects most in need of funding assistance, consistent with the Government’s objectives.

**2.2** The ANAO has assessed the performance of DCITA in determining either the need for the programs subject to audit or the areas to be targeted by the programs as:

BITS Incubator	ICT Incubators	BITS ANP	ANP2	BITS Intelligent Island	NCF	Towns over 500
✓✓	✓✓	✓✓	✓✓	✓✓	✓✓	✓✓

- ✓✓ complies with better practice principle in all material respects
- ✓ partially complies with better practice principle, but with some room for improvement
- × does not comply with better practice principle, with significant shortcomings
- na not applicable

**2.3** DCITA indicated that after extensive (but undocumented) discussions between the DCITA and the Minister’s office, the government announced on 20 June 1999 a commitment to establish the \$158 million BITS Program, comprising *Incubator*, the *ANP* and *Intelligent Island*. After its announcement, the ANAO found that DCITA satisfactorily framed and focused the first two programs through a scoping consultancy (*ANP*) and extensive consultations with stakeholders including Australian Government departments, State and Territory departments, research institutions and industry (*BITS Incubator* and *ANP*). A multi-jurisdictional Board was established under the *Intelligent Island*

*Program* to determine the nature, scope and focus of financial assistance to Tasmania's IT sector within the parameters agreed to by the Australian and Tasmanian Governments.

**2.4** The *NCF* and *Towns over 500* programs were established to address particular recommendations from the Telecommunications Service Inquiry (Besley Report). Interdepartmental committees were established to progress development of the government's response, culminating in the \$50 million *NCF Program* and \$37.7 million *Towns over 500 Program*. The ANAO considers that documentation underpinning the development of these two programs indicates appropriate consultation with key stakeholders and analysis of the needs for the programs, in the context of the government's policy direction.

**2.5** The extensions to the *BITS Incubator Program* (that is, the *ICT Incubators Program*) and the *ANP* (*ANP2*) were justified primarily on the basis of an independent evaluation (*BITS Incubator Program*) and a mid-term review (*ANP*). The evaluation and review found that the programs were achieving or were on the path to achieving their objectives, but needed a period of extra government funding to give the projects the opportunity to become self-sustaining (*BITS Incubator Program*) and fully realise their benefits (*BITS Incubator* and *ANP* programs).

**2.6** The ANAO considers that DCITA determined either the need for the programs subject to audit or the areas to be targeted by the programs in accordance with sound practice.

## Defining operational program objectives

**2.7** Grant programs should operate under clearly defined and documented operational objectives that are authorised or endorsed by the appropriate authority (for example, Ministers). The objectives should be capable of measurement using an appropriate combination of quantitative, qualitative and milestone information. This will allow administering departments to determine whether programs are achieving their objectives and will aid future decisions for continuing or concluding the programs.

**2.8** The ANAO has assessed the performance of DCITA in defining operational objectives for the programs subject to audit as:

BITS Incubator	ICT Incubators	BITS ANP	ANP2	BITS Intelligent Island	NCF	Towns over 500
✓✓	✓✓	✓✓	✓✓	✓✓	✓✓	✓✓

- ✓✓ complies with better practice principle in all material respects
- ✓ partially complies with better practice principle, but with some room for improvement
- × does not comply with better practice principle, with significant shortcomings
- na not applicable

**2.9** A summary of the respective objectives of the programs subject to audit can be found in Table 1.4 in Chapter 1.

**2.10** The ANAO found that the mid-term reviews of the *ANP* and *NCF* programs demonstrated that the programs' objectives were measurable, mainly in qualitative and milestone achievement terms (indicating the potential for the same to occur for *ANP2*).

**2.11** The independent evaluation of the *BITS Incubator Program* demonstrated that the program's objectives were measurable using a combination of quantitative and qualitative measures (which can also be applied to the *ICT Incubators Program*). Similarly, the Implementation Plan for the *Intelligent Island Program* listed a series of quantitative and qualitative performance measures for each of its seven funded initiatives. (Although the link between the initiatives and the program's objective has now been strengthened in the subsequent Intelligent Island Business Plan).

**2.12** The objective of the *Towns over 500 Program*—to provide 100 per cent mobile phone coverage in designated towns within designated boundaries—lends itself to quantitative measurement.

**2.13** The ANAO considers that DCITA defined and documented authoritative program objectives in terms of measurable outcomes for all programs subject to audit in compliance with better practice principles.

## Program risk management

**2.14** An appropriately documented risk management methodology can assist grant administrators to streamline program planning, implementation, monitoring and review processes. Risk management focuses on maximising

the value for money of grant expenditure through minimising adverse impacts by identifying and treating potential risks.

**2.15** The ANAO has assessed the performance of DCITA in managing program risks for the programs subject to audit as:

BITS Incubator	ICT Incubators	BITS ANP	ANP2	BITS Intelligent Island	NCF	Towns over 500
✓	✓	✓	✓	✓	✓✓	✓

✓✓ complies with better practice principle in all material respects

✓ partially complies with better practice principle, but with some room for improvement

✗ does not comply with better practice principle, with significant shortcomings

na not applicable

**2.16** DCITA has assessed the 'Poor Grant Management' risk within the department as either a medium, significant or high risk area over the life of the programs audited. At the start of 2004–05, 'Poor Grant Management' was assessed as a significant risk area for DCITA, requiring 'appropriate risk treatment strategies [to] be identified, as well as the establishment of monitoring and review regimes'. Nevertheless, DCITA's ICT Division, the division in which the programs subject to audit have been managed, has more recently reassessed the 'Poor Grant Management' risk *as it applies to their division* as moderate. The ICT Division considers that it now has additional controls in place for this risk and therefore further risk treatments are not required.

**2.17** The ANAO found that, of the programs subject to audit, DCITA's ICT Division (from hereon referred to as 'DCITA') developed a comprehensive program risk assessment only for the *NCF Program*.<sup>5</sup> The risk assessment undertaken in late-2001 covered the project selection process, deed negotiations and the monitoring of grant recipients. It identified and rated each risk and listed the controls or risk mitigation treatments that would be put in place to manage the risks. All risks were rated as either medium or significant. The ANAO considers that the *NCF Program* risk assessment helped DCITA establish a suitable control environment (or, at the very least, provided assurance to DCITA of the adequacy of the control environment) for the program. Of the programs subject to audit, the *NCF Program* began later than

<sup>5</sup> Basic risk assessment plans were also developed for the *ICT Incubators* and *ANP2* programs as part of the Implementation Plans lodged with the Department of the Prime Minister and Cabinet. However, the ANAO does not consider these to be comprehensive.

most, possibly reflecting an increasing focus on formal program risk management in DCITA.

**2.18** Although most programs subject to audit did not have a formal program risk assessment, DCITA instituted appropriate management controls to manage most of their risks. Some of these are listed below in *Designing programs for value for money* and *Designing programs for accountability* sections in this Chapter.

**2.19** However, as noted elsewhere in this report, the performance of some of the programs subject to audit could have improved had DCITA better managed some of the risks, including:

- the sustainability of BITS and ICT incubators after funding ceased (see *Establishing funding deeds* in Chapter 4);
- the appropriateness of performance measures and targets for the ICT incubators (see *Establishing funding deeds* in Chapter 4);
- the process surrounding the call for BITS incubators' submissions for extra funding under the *ICT Incubators Program* (see *Designing programs for value for money* in this chapter below);
- the rigour surrounding the assessment of ANP grantees' submissions for extra funding and the negotiation of ANP2 funding deeds (see *Designing programs for value for money* in this chapter below); and
- the slow implementation of the *Intelligent Island Program* (see *Monitoring progress and payments* in Chapter 4).

**2.20** DCITA could have also better managed the risk of extended delays to NCF funding deed negotiations (see *Establishing funding agreements* in Chapter 4 below). However, due to the grantees' rapid deployment of services once deed negotiations were completed, this risk did not impact significantly on the timely achievement of all but one of the NCF projects.

**2.21** The ANAO considers that with improved risk management practices, DCITA would have greater assurance that all significant risks to programs have been identified and mitigation strategies put in place. In June 2003, the *Review of the Administrative Efficiency of Networking the Nation* recommended that 'DCITA undertake a formal, documented risk assessment for each grant program and prepare a risk management plan' for future grant programs. The need for formal risk management has been more recently reinforced in

DCITA's *Practical Guide to Program Administration* (April 2005) where it is noted that:

A risk management strategy based on a well-documented, thorough and careful risk identification and assessment should be developed during the program design phase. It will assist officers to identify risks early and implement, monitor and review processes in the light of this information.

**2.22** The ANAO further considers that DCITA could use its Fraud Risk Assessments as a starting point for program risk management due to the similarity in applicable risks. The current Fraud Risk Assessment contains a comprehensive section on fraud risks and current management controls for grant management that would no doubt overlap with the risks and controls applicable to program risk management.

**2.23** DCITA indicated that its risk management approach had matured and become more formalised since most of the programs subject to audit began between 1999 and 2001. DCITA considers that a formal risk management plan would now be a regular feature of any future grant program it manages.

**2.24** Risk management is only as good as users' preparedness to apply the management controls and treatments to address risks. The ANAO observed occasions where DCITA did not always adhere to its management controls for the *NCF Program* (in respect of a specification review and audited financial reports for one *NCF* project) and the *Intelligent Island Program* (in respect of performance measurement). These are discussed later in the report.

**2.25** The ANAO considers that DCITA's program risk management, for the majority of programs subject to audit, only partially complied with better practice principles. Only in the *NCF Program* did program risk management comply with better practice principles.

## Designing programs for value for money

**2.26** A goal in designing programs should be to maximise value for money in achieving their objectives. This can be done by maximising outputs and outcomes for a given level of input or minimising inputs to achieve a specific level of outputs or specific outcomes. In grant programs, project selection processes should (i) encourage applicants to put forward their best possible applications, and (ii) select the best applications that will achieve the program objectives, within a value for money context.

**2.27** Value for money also extends to agencies' cost of administering programs. Insufficient administrative resources to manage grant programs increase the risk that the program's objectives may not be achieved in an efficient, effective and timely manner. On the other hand, the application of too much administrative effort is not an efficient use of funds and may divert expenditure away from the effective achievement of the objectives of the grant program.

**2.28** The ANAO has assessed the performance of DCITA in designing the programs subject to audit for value for money as:

BITS Incubator	ICT Incubators	BITS ANP	ANP2	BITS Intelligent Island	NCF	Towns over 500
✓✓	✓	✓✓	×	✓✓	✓✓	✓✓

- ✓✓ complies with better practice principle in all material respects
- ✓ partially complies with better practice principle, but with some room for improvement
- × does not comply with better practice principle, with significant shortcomings
- na not applicable

**2.29** The ANAO considers that administrative responsibilities were established and resources allocated early in the life of the programs subject to audit or in a timely manner during the programs' implementation. The administrative responsibilities that aided the programs' value for money included:

- using DCITA staff to design program guidelines and tender requirements, and assess applications and tenders (applied in all programs subject to audit, except *Intelligent Island*);<sup>6</sup>
- engaging technical consultants during the selection process to separately assess elements of shortlisted applications and tenders (*BITS Incubator*, *ANP*, *NCF*, and *Towns over 500* programs);
- establishing independent Expert Advisory Panels to make project selection recommendations to the Minister (*BITS Incubator*, *ANP*, and *NCF* programs);<sup>7</sup>

<sup>6</sup> Under the *Intelligent Island Program*, the Board and the Project Executive (both comprising representatives from DCITA and Tasmania) approved program guidelines and applications for funding under the seven *Intelligent Island* initiatives. However, this was outside the scope of the audit.

<sup>7</sup> In addition, the Selection Panel for the *ICT Incubators Program* involved representatives from DCITA and the Department of Industry, Tourism and Resources.

- taking into account generic and special funding conditions recommended by the Expert Advisory Panels and Selection Panels during funding deed and contract negotiations (*BITS Incubator*, *ANP*, *NCF* and *Towns over 500* programs);
- using DCITA staff to negotiate funding deeds, memoranda of understanding (MOUs) and contract, monitor grantees' performance against milestones, indicators and targets and manage the programs (all programs subject to audit);
- liaising with DCITA's Legal Group when negotiating funding deeds, MOUs and contract and on other legal matters impacting the programs from time to time (all programs subject to audit); and
- undertaking independent evaluations or mid-point reviews conducted by DCITA staff managing the programs to examine the programs (conducted—*BITS Incubator*, *ANP*, and *NCF* programs; and planned—*ICT Incubators* and *ANP2* programs).

**2.30** The ANAO considers that the administrative controls listed above, as exercised by DCITA, provide assurance of DCITA's goal to design the *BITS Incubator*, *ANP*, *Intelligent Island*, *NCF* and *Towns over 500* programs to maximise their value for money.

### **Value for money in the ICT Incubators Program**

**2.31** The ANAO considers that value for money in the *ICT Incubators Program* was inhibited for two reasons:

- The extent of the advance notice of possible post-selection outcomes; and
- The standardisation of some of the key financial and performance targets to be applied to all incubators—particularly co-investment targets.

#### *Advance notice of possible post-selection outcomes*

**2.32** DCITA advised the 10 BITS incubators,<sup>8</sup> in advance, that '6 to 8 BITS incubators' would receive further funding under the *ICT Incubators Program* and those that were funded would receive equal funding (regardless of the relative merit of their submissions). The ANAO considers that this had

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<sup>8</sup> Includes the Tasmanian incubator funded under the BITS *Intelligent Island Program*.

implications for the competitiveness of the selection process and the quality of the submissions received.

**2.33** At the time of the selection process, the private equity market was generally aware of ongoing viability concerns regarding two BITS incubators.<sup>9</sup> With only eight 'viable' incubators to choose from and equal funding for all selected, some incubators may have considered that they did not need to produce a high quality submission to be one of the '6 to 8 incubators' selected to receive further funding. As noted below, this appears to be what occurred.

**2.34** Although noting that all top eight rated incubators could still be effective in delivering services, the Selection Panel for the *ICT Incubators Program* also noted its disappointment that only four incubators made an obvious effort to present fully developed business plans in their submissions. The inference was that some incubators 'rested on their laurels' or believed that they were not likely to be funded based on their past performance, even though past incubator performance was only one selection criterion. Given that eight incubators were ultimately funded under the *ICT Incubators Program*, four incubators were funded who had not made an obvious effort in preparing their submissions.

**2.35** DCITA considers that it took the best approach to selecting ICT incubators given the program's parameters. Program guidelines reflected the Government's May 2004 announcement that only existing incubators would receive funding. The need to keep a 'national footprint' (that is, a geographic spread of projects) meant that this was unlikely to be achieved with fewer than six incubators. DCITA considered that competition was created because two to four incubators would not receive funding. DCITA justified equal funding on the basis that a certain minimum level of funding for each incubator would be needed for them to remain sustainable and with the limited amount of funding provided it would not have been possible to have a great difference between amounts.

**2.36** The ANAO considers that limiting the information announced in advance concerning possible post-selection outcomes would have improved the selection process. The competitiveness of the selection process and the quality of submissions received would have almost certainly been enhanced had DCITA not announced in advance:

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<sup>9</sup> Two BITS incubators, Item3 and OITI, effectively became holding companies for their portfolio of BITS incubatees from July 2003.

- the amount of funding each successful incubator would receive (above a pre-announced minimum level); and
- the number of likely successful incubators.

**2.37** Increased competition may have led incubator owners to propose greater contributions of cash and in-kind outgoings from themselves for their incubatees. (The ANAO found that six of the eight ICT incubator funding deeds required incubator owners to contribute less than \$1 million cash and in-kind outgoings to their incubators, including one that required no contribution from the incubator's owners. These contributions from incubator owners represent less than a quarter of DCITA's contributions).

*Standardised financial and performance targets for ICT incubators*

**2.38** When negotiating *ICT Incubators* funding deeds, DCITA took a conscious decision to standardise the co-investment targets for seven of the eight incubators. Co-investment, which is the amount of non-ICT incubator funding the incubators agreed to raise from other sources for investment in their incubatees over the life of the deed, was set to match equally the amount of Australian Government funding they received (\$4.57 million). (The remaining incubator had a greater co-investment target to reflect its unique position of having a significant carry-forward of unspent and uncommitted *BITS Incubator* funding.)

**2.39** The ANAO questions the merits of standardised targets and the setting of a common, low co-investment target given that:

- incubators use widely varying models of incubation;
- many BITS incubators achieved or bettered (sometimes significantly) a 1:1 BITS incubator to co-investment funding ratio;
- unlike at the start of the *BITS Incubator Program*, incubators have established processes, networks and experienced staff;
- the *ICT Incubators* submissions of three incubators proposed significantly greater co-investment targets; and
- incubators can count new co-investment raised across their entire portfolios of BITS and ICT incubatees to meet co-investment targets.

**2.40** The risk with setting performance targets too low is that, once achieved, grantees will not make every effort to maximise their performance. Better results are likely to be achieved by setting challenging performance

targets that 'stretch' the recipients, but are still achievable. This may require tailoring the co-investment targets of each incubator to reflect their past financial performance and what they proposed in their submissions.

**2.41** DCITA considers that setting common co-investment targets for all incubators was realistic given potential uncertainties in the venture capital market, while still appropriately leveraging government funds. Previous experience showed that attracting co-investment for incubatees is cyclical and relies on many factors outside incubators' control. DCITA indicated that many milestone targets for BITS incubators were required to be revised downwards because they were too 'challenging' in the prevailing 'tech wreck' environment (see *Monitoring progress and payments* in Chapter 4 below). Accordingly, ICT incubators were advised in negotiations to set more realistic targets and that downward revisions of milestones would not be considered except under the most exceptional of circumstances. DCITA also considered that there is a very substantial commercial incentive for incubators to attract additional co-investment over and above target levels. Consequently, even if the targets were low, this did not act as a disincentive for them to be exceeded.

**2.42** DCITA reports that, as at December 2005 (and only 18 months into the four year program), five incubators had already met their full co-investment requirement under the deeds and the remainder are exceeding their progressive co-investment targets. The ANAO considers that it would have been better for DCITA to set more challenging targets and face the risk of having to vary them downwards to account for unforeseeable 'outside' events, rather than set lower targets that, in effect, factor in this risk.

## **Value for money in ANP2**

**2.43** In mid-2003, all *ANP* grantees agreed to make submissions to the *ANP* mid-term review to outline their projects' activities and performance. As part of their submissions, the grantees indicated what they would like to do if further funding was forthcoming from the Australian Government for an extension to the *ANP* program. Activities and sub-projects were described and a draft budget calculated. The format of the submissions for further funding was essentially left in the hands of grantees. Subsequently, *ANP* grantees' submissions formed the basis for allocating *ANP2* funding to the projects.

**2.44** The ANAO considers that:

- additional rigour in respect of seeking and considering submissions for further funding from existing *ANP* projects; and
- seeking technical advice on the submissions and through the negotiations of the *ANP2* funding deeds;

may have led to increased value for money from *ANP2*.

#### *Rigour of submission assessment*

**2.45** DCITA considers that the *ANP* guidelines were still applicable and fully appropriate for *ANP2*, precluding the need for separate guidelines. DCITA also considers that the *ANP* mid-term review process, which included a detailed assessment of all three projects against comprehensive key performance indicators, allowed the submissions and associated value for money to be judged against performance to date. The submissions were, in effect, a direct continuation of the existing program activities.

**2.46** However, the ANAO considers that had *ANP* grantees provided better submissions (based on additional guidance from DCITA), more thorough assessments of the value for money of each grantee's submission could have been made. Unlike *ANP* applications, *ANP2* submissions lacked consistent structure and content that would have aided their consideration by DCITA. In addition, for at least one of the three funded projects, the grantee was required to develop new business systems and associated software applications, services and processes.

**2.47** Further, there was no documentation on file evidencing DCITA's critical assessment of the *ANP* grantees' submissions for further funding. As grantees were asked for submissions it could reasonably be expected that DCITA would assess their relative merits, in conjunction with grantees' performance to date. This assessment would have improved the advice provided to the Minister for funding the grantees. An explicit assessment of each projects' submission would have better demonstrated their value for money.

## Recommendation No.1

**2.48** The ANAO recommends that when DCITA considers providing further funding to existing programs or projects, DCITA:

- (a) develops program guidelines and communication strategies to improve the quality of submissions; and
- (b) documents its assessment of the relative merit of the submissions.

### *DCITA response*

**2.49** DCITA agrees, noting that its practice is to follow these procedures where appropriate.

### *Seeking technical advice*

**2.50** In addition, unlike *ANP*, DCITA did not engage consultants under *ANP2* to provide specialist technical advice on the grantees' submissions for further funding or during deed negotiations. The ANAO considers that in-house or external technical advisors working with DCITA staff could have added value. Outputs and outcomes for research are difficult to define. Technical advisors may have been able to more precisely define the acceptance criteria of the funding deed milestones. (For example, rather than '... system demonstrated to industrial partner', the milestone could have described whether it was to be demonstrated in a test or live environment, whether all features would be ready and integrated for the demonstration, etc). The technical advisors could have also commented on how any changes to key features and specifications negotiated by the parties between the submissions and the finalised deeds impacted on the projects' value for money. The ANAO notes that there were changes to key features and specifications between the CeNTIE project's submission and its final signed funding deed.

**2.51** DCITA indicated that the major network implementation phase of all three projects was completed during *ANP*, with only minor upgrades or extensions to the networks planned under *ANP2*. DCITA considered that:

- by the end of *ANP*, it was quite familiar with the research aspects of the various software applications (and their costs) that were continued and extended under *ANP2*;
- external technical advice, at a significant cost to DCITA, would not have added significant value to the deed negotiations; and

- the software applications development and networking technologies research involved is at the leading edge and it was doubtful there would have been appropriate high level technical expertise outside the ANP groups.

## Departmental funds used to manage programs

**2.52** At the start of all programs subject to audit, except *Intelligent Island*, the government allocated separate funds for DCITA's costs of managing the programs subject to audit. Appropriation funding for these costs for all of DCITA's individual programs form part of DCITA's base funding, from which it is required to manage all its activities. The Department's Secretary, in consultation with her senior executives, allocates departmental funds (running costs) across DCITA's divisions, and outputs and outcomes, to manage all of DCITA's programs. Monitoring of such allocated departmental funds does not extend to the individual program level.

**2.53** The ANAO considers that DCITA has a disciplined process for the budgeting and monitoring of running costs across its divisions and outputs and outcomes. The ANAO noted that DCITA:

- uses zero-based budgeting to construct its annual departmental funds budgets by division, and by expenditure and revenue line item;
- compares current budgets to the prior year's budgets and justifies variations;
- reviews budgets mid-year with variations requiring justification and approval by the Secretary; and
- monitors revenue and expenditure against budgets monthly with variations noted for consideration by the Secretary.

**2.54** This process allocates DCITA's resources efficiently and effectively to manage its Divisions and, by extension, the programs within those Divisions—including the programs subject to audit managed within DCITA's ICT Division.

## Conclusion

**2.55** The ANAO considers that the administrative controls for the *BITS Incubator*, *ANP*, *Intelligent Island*, *NCF* and *Towns over 500* programs, as implemented and exercised by DCITA, provide assurance that DCITA complied with the better practice principle of maximising their value for

money. However, greater leverage may have been achieved from grant funding in the *ICT Incubators* and *ANP2* programs. The ANAO considers that the lack of documentation evidencing DCITA’s assessment of *ANP* grantees’ submissions for further funding is a significant shortcoming for the *ANP2* program.

Designing programs for accountability

2.56 The design of grant programs should ensure that decisions approving or refusing applications for grants are transparent and well documented. The criteria and basis for recommendations and decisions at all stages of the grant process—including appraisal, approval and for payments—must be effectively documented. The needs of administrative law need to be considered early in the planning process, particularly procedural fairness, and privacy.

2.57 The ANAO has assessed the performance of DCITA in designing the programs subject to audit for accountability as:

BITS Incubator	ICT Incubators	BITS ANP	ANP2	BITS Intelligent Island	NCF	Towns over 500
✓✓	✓✓	✓✓	✓✓	✓✓	✓✓	✓✓

- ✓✓ complies with better practice principle in all material respects
- ✓ partially complies with better practice principle, but with some room for improvement
- ✗ does not comply with better practice principle, with significant shortcomings
- na not applicable

2.58 The ANAO noted the general similarity in the control environments for the selection and management of projects across the *BITS Incubator*, *ANP*, *NCF* and *Towns over 500* programs although they were administered by various managers over time in two branches of DCITA. The ANAO considers that the ICT Division of DCITA, where the programs subject to audit have been managed, demonstrated a high degree of understanding of the principles of better grant management practice. The ANAO commends DCITA’s attempt to further reinforce better grant management practice within the department through its recently-produced *Practical Guide to Program Management*. This Guide synthesises better practice and key lessons derived from administering its programs.

2.59 However, the ANAO considers that processes surrounding calling for and assessing submissions to extend existing projects under the *ICT Incubators* and *ANP2* programs were not as rigorous as for the preceding programs. This

resulted in some partial and non-compliance with better practice principles of grant management (see *Designing programs for value for money* in this chapter above). The ANAO considers that DCITA should maintain the standards of rigour it applies in original project assessments to project extensions.

**2.60** Accountability mechanisms incorporated into the design of the selection processes for the programs subject to audit<sup>10</sup> included:

- program guidelines, produced upfront, that detailed the selection criteria (applied to the *BITS Incubator*, *ICT Incubators*, *ANP*, and *NCF* programs);
- probity auditors or advisers who oversaw the development of program guidelines and the selection process (*BITS Incubator*, *ANP*, *NCF* and *Towns over 500* programs);<sup>11</sup>
- probity guidelines for DCITA and other Australian Government departments to apply during application assessment (*NCF Program*);
- technical consultants who assessed shortlisted applications (*BITS Incubator*, *ANP*, *NCF* and *Towns over 500* programs);
- Expert Advisory Panels or Selection Panel who independently assessed shortlisted applications and provided recommendations to the Minister (*BITS Incubator*, *ICT Incubators*, *ANP*, *NCF* and *Towns over 500* programs);
- using conflict of interest declarations for all assessors, where applicable (for example, from other departments, consultants and Panel members) (all programs subject to audit);
- legal consultants who developed the standard funding deeds to manage the risks posed by the programs (*BITS Incubator*, *ICT Incubators* and *ANP* programs); and
- mid-term review or evaluation of predecessor programs and the grantees' performance (*BITS Incubator Program* evaluation, which preceded the *ICT Incubators Program*; and the *ANP* mid-term review, which preceded *ANP2*).

<sup>10</sup> Not applicable to the *Intelligent Island Program*.

<sup>11</sup> DCITA also engaged a probity advisor for the *ICT Incubators Program* to oversee the development of program guidelines.

**2.61** The ANAO noted that DCITA engaged its Internal Auditors as probity auditors for the *BITS Incubator*, *ANP* and *NCF* programs. The ANAO considers that this has inhibited the Internal Auditor from later auditing these programs due to potential conflicts of interest. As a direct consequence of the internal auditor's engagement as probity auditor for the *BITS Incubator Program*, this program was removed from the Draft Internal Audit Program for 2001–02. Internal Audit has not conducted an audit into the *BITS Incubator*, *ANP* or *NCF* programs since that time. The ANAO considers that to better manage potential conflict of interest perceptions, DCITA should consider the impact of using its internal auditor, on a case-by-case basis, in future program selection processes. In some instances it may be more efficient and/or effective to engage another firm to carry out an internal audit of such programs. DCITA indicated that it no longer engages its internal auditor as probity auditor for specific funding programs.

**2.62** Accountability mechanisms incorporated into the monitoring of grantees included:

- engaging technical consultants during funding deed and contract negotiations (applied in the *BITS Incubator*, *NCF*, and *Towns over 500* programs);
- incorporating milestones, conflict of interest provisions and information access provisions in funding deeds and the contract (all programs subject to audit, except *Intelligent Island*);
- linking payments to the achievement of measurable milestones and performance measures (all programs subject to audit, except *Intelligent Island*);
- appropriately segregating duties such as the assessment and approval of payments to grantees (all programs subject to audit);
- the Australian Government having membership on the Intelligent Island Board and on its replacement, the Project Executive;
- the grantees' submission of regular financial and performance reports (all programs subject to audit);
- the grantees' submission of annual reports, including an independently audited financial report (all programs subject to audit);

- the grantees' submission of final reports at the end of the programs covering the entire life of each project (all programs subject to audit, except *Intelligent Island* and *Towns over 500*); and
- mid-term reviews and/or evaluation of the program and the grantees' performance (conducted—*BITS Incubator*, *ANP*, *NCF*; and planned—*ICT Incubators* and *ANP2* programs).

**2.63** Overall, the ANAO considers that the programs subject to audit have been designed with sound accountability measures in place.

## Establishing performance measures

**2.64** A performance measurement framework is essential for grant administrators to assess the effectiveness of their programs. Relevant, accurate, timely, accessible, interpretable and coherent performance information contributes to timely and effective decision-making in managing and adjusting grant programs, and contributes to the accountability of agencies for their performance.

**2.65** The ANAO has assessed the performance of DCITA in establishing performance measures for the programs subject to audit as:

BITS Incubator	ICT Incubators	BITS ANP	ANP2	BITS Intelligent Island	NCF	Towns over 500
✓	✓✓	✓	✓	✓	✓✓	✓✓

- ✓✓ complies with better practice principle in all material respects
- ✓ partially complies with better practice principle, but with some room for improvement
- × does not comply with better practice principle, with significant shortcomings
- na not applicable

**2.66** Refer to Appendix 1 for a list of some of the performance measures used for the programs subject to audit.

**2.67** DCITA assessed the performance of programs subject to audit against certain quantitative, but mainly qualitative, measures. For some programs, the performance measures were closely linked to the program objectives (*ICT Incubators*, *NCF*, and *Towns over 500* programs), but for other programs, the links were not as close (*BITS Incubator*, *ANP*, *ANP2*, and *Intelligent Island* programs). The ANAO found that:

- DCITA did not explicitly link the quantitative performance measures to the *BITS Incubator Program* objectives (although the independent

evaluation of the program was able to assess its performance using mainly qualitative data). DCITA has rectified this situation under the subsequent *ICT Incubators Program*;

- DCITA could consider the *ANP*'s and *ANP2*'s performance against additional performance measures (as cited in the *ANP* mid-term review); and
- although performance measures were established for the seven *Intelligent Island* initiatives,<sup>12</sup> the links between the initiatives and the program's objectives was not formally established until two years into the program.

**2.68** Although the performance of all programs subject to audit can be measured qualitatively, some programs more easily lend themselves to quantitative measurement than others. For example, quantitative measurement is relatively straightforward in respect of the contract with Telstra to deliver the *Towns over 500 Program*. The contract clearly establishes start and finish dates for complete rollout, and the number of towns where services are to be rolled out each quarter. The contract also clearly specifies the performance required at each site (100 per cent hand-held coverage in a designated area, excluding specified black spots, measured to the Bell 90/90 performance standard).

**2.69** On the other hand, meaningful quantitative performance measures are difficult to develop for research activities, which is the principal output of *ANP2*. DCITA indicated that it has endeavoured to find practical quantitative performance measures for the program, but it has not proved possible. The ANAO considers that this places greater importance on the specification of project milestones in funding deeds that measure real outputs and outcomes from the strands of research funded.

**2.70** Another important consideration for program performance measurement is the specification of performance baselines at the start of the programs. This is necessary to, as much as possible, isolate the performance of the programs from pre-existing results. In most respects, the programs subject to audit were focused on areas that had a 'zero starting base', negating the need for performance baselines. The *BITS Incubator* and *ICT Incubators* programs were attempting to fill a gap in the market concerning early-stage

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<sup>12</sup> DCITA privately expressed reservations about the adequacy of these performance indicators (see *Monitoring progress and payments* in Chapter 4).

incubation. The *ANP* and *ANP2* programs were contributing to the development of advanced network infrastructure (which was absent at the start of the programs). The *NCF Program* funded a generational leap in technology by installing broadband in education and health facilities in areas that had either dial-up access, expensive ISDN facilities or only basic telephone services. The *Towns over 500 Program* established mobile phone coverage in areas without, or with inadequate, coverage.

**2.71** The only program subject to audit with a relevant performance baseline has been the *Intelligent Island Program*. The *Intelligent Island Business Plan* (2003, but updated in July 2004) identifies performance baseline measures for each of the program's outputs.

**2.72** The performance measurement and monitoring strategies for the *ICT Incubators*, *NCF* and *Towns over 500* programs complied with better practice principles. The performance indicators of the remaining programs subject to audit only partially complied with better practice principles as they did not comprehensively measure and link the programs' performance against their respective objectives early in the lives of the programs.

## Selecting funding strategies

**2.73** Grant programs are rarely the only means through which a program's objectives can be achieved. Other means include the provision of government loans and taxation deductions or rebates. Even where a grant program is the preferred method of delivery, there are usually different funding options to consider (for example, entitlements versus merit-based assessments). Whatever method is chosen, care should be taken to consider general cash management principles. Where payments are made in advance, there should be a net benefit in doing so.

**2.74** The ANAO has assessed the performance of DCITA in selecting funding strategies for the programs subject to audit as:

BITS Incubator	ICT Incubators	BITS ANP	ANP2	BITS Intelligent Island	NCF	Towns over 500
✓✓	✓✓	✓✓	✓✓	✓✓	✓✓	✓✓

- ✓✓ complies with better practice principle in all material respects
- ✓ partially complies with better practice principle, but with some room for improvement
- × does not comply with better practice principle, with significant shortcomings
- na not applicable

**2.75** The ANAO examined DCITA documentation outlining various options for delivering the programs subject to audit. The ANAO agreed with DCITA that merit-based, competitive approaches to call for proposals or tenders appeared to be the best way to establish:

- the innovative *BITS Incubator Program* with incubator centres in each state and territory and the potential for many different and worthy models of incubation;
- the high technology *ANP*, given the moderate amount of funding for the task;
- the *NCF*, given the moderate amount of funding available to address extensive and costly telecommunications issues in regional and rural areas; and
- the *Towns over 500 Program* to address specific and definable gaps in hand-held mobile phone coverage in certain regional centres.

**2.76** The *BITS Fact Sheet*, prepared by the Minister's Office soon after the program's announcement, envisaged the creation of an Intelligent Island council comprising Australian and Tasmanian governments, among other industry and education sector representatives, who would develop a detailed implementation plan to give effect to the program's objectives. This was essentially how the *Intelligent Island Program* was established.

**2.77** The *ICT Incubators* and *ANP2* programs are essentially program extensions to provide additional government funding to existing projects to give them the opportunity to become self-sustaining (*BITS Incubator Program*) and fully realise their benefits (*BITS Incubator* and *ANP* programs). The ANAO considers that the program extensions are a logical means to achieve the desired outcomes.

**2.78** Grant payments under all programs subject to audit, except *Intelligent Island*, are linked to the achievement of funding deed or contract milestones and/or performance measures. Most programs make payments in advance, sufficient to cover estimated expenditure over the next reporting period (usually quarterly). The *Intelligent Island* MOUs required the advance payment of \$20 million (or half of the grant) to the Tasmanian government following completion and acceptance of the Implementation Plan. The remaining \$20 million was to be paid in accordance with the terms of the Implementation Plan. However, the interest earned by the Tasmanian

Government on unspent *Intelligent Island* funds is treated as part of the grant and can be used to fund administrative costs of the Intelligent Island Board and Secretariat. The ANAO considers that DCITA adequately considered cash management principles when establishing payment profiles for each grant and grant program.

**2.79** The ANAO considers that DCITA selected funding strategies in compliance with better practice principles by considering the risks and benefits of alternative funding strategies.

## Considering taxation issues

**2.80** Goods and services tax (GST) may apply to grant payments and certain grant payments may be subject to income tax in the hands of certain recipients. Grant-giving organisations should advise potential recipients to seek independent legal and financial advice if they are uncertain of their taxation obligations.

**2.81** The ANAO has assessed the performance of DCITA in considering taxation issues for the programs subject to audit as:

BITS Incubator	ICT Incubators	BITS ANP	ANP2	BITS Intelligent Island	NCF	Towns over 500
✓✓	✓✓	✓✓	✓✓	✓✓	✓✓	✓✓

- ✓✓ complies with better practice principle in all material respects
- ✓ partially complies with better practice principle, but with some room for improvement
- ✗ does not comply with better practice principle, with significant shortcomings
- na not applicable

**2.82** The program guidelines for the *BITS Incubator*, *ICT Incubators*, *ANP*, and *NCF* programs made it clear that successful applicants would be responsible to the Australian Taxation Office for any taxation requirements and how GST applied to the programs. Generally this entailed ‘grossing up’ grants to GST-registered grantees to take account of applicable GST. Grantees under *ANP2* were familiar with their taxation requirements due to their involvement in the *ANP*. DCITA indicated to tenderers under the *Towns over 500 Program* that they would be responsible for all taxes and charges. GST is not applicable to the *Intelligent Island Program* in respect of the payments from the Australian Government to the Tasmanian Government.

**2.83** The ANAO considers that DCITA considered the tax implications for all programs subject to audit in compliance with better practice principles.

## Producing program guidelines

**2.84** Clear, consistent and well-documented program guidelines are an important component of an effective grant program administration system. A reference source for policy guidance, administrative procedures, appraisal criteria, monitoring requirements, evaluation strategies and standard forms helps to ensure consistent and efficient administration.

**2.85** The ANAO has assessed the performance of DCITA in producing guidelines for the programs subject to audit as:

BITS Incubator	ICT Incubators	BITS ANP	ANP2	BITS Intelligent Island	NCF	Towns over 500
✓✓	✓	✓✓	x	✓✓	✓✓	✓✓

- ✓✓ complies with better practice principle in all material respects
- ✓ partially complies with better practice principle, but with some room for improvement
- x does not comply with better practice principle, with significant shortcomings
- na not applicable

**2.86** DCITA released program guidelines for the *BITS Incubator*, *ICT Incubators*, *ANP*, and *NCF* programs that accompanied the call for proposals. The guidelines typically outlined:

- the program objective, description and approach;
- eligibility criteria;
- the requirements surrounding the lodgement of applications;
- the selection process, including the merit-based selection criteria and related explanatory information;
- the intended use of an independent expert panel to advise DCITA before selection decisions are made (not for the *ICT Incubators Program*);
- that the Minister will make the final selection decisions; and
- the key conditions which successful applicants would be required to meet.

**2.87** However, as noted in *Designing programs for value for money* above, the ANAO considers that the competitiveness of the selection process for the *ICT Incubators Program* would have been enhanced had DCITA limited the information contained in program guidelines on possible post-selection outcomes.

**2.88** As all three existing *ANP* grantees were to receive *ANP2* funding, DCITA saw no need to produce program guidelines. Nevertheless, as noted in *Designing programs for value for money* above, greater guidance from DCITA on the requirements for *ANP* grantees' submissions for further funding may have improved the quality and comprehensiveness of the submissions.

**2.89** The ANAO also considers that the Request for Tender document for the *Towns over 500 Program* adequately outlined the requirements the successful tender would have to abide by.

**2.90** Program guidelines for the *Intelligent Island Program* are effectively contained in the MOUs between the Australian and Tasmanian Governments and the accompanying Implementation/Business Plans. The ANAO considers that these documents provide satisfactory parameters for the program to meet its objective.

**2.91** The ANAO considers that DCITA developed sound program guidelines or equivalents for all programs subject to audit except *ICT Incubators* and *ANP2*. The reasons for the ANAO assessing program guidelines for the *ICT Incubators* and *ANP2* programs as partially compliant and non-compliant, respectively, are noted above.

### 3. Selecting Projects

*This chapter assesses DCITA’s performance in selecting the best projects to meet the objectives of the programs subject to audit, including calling for applications, handling and assessing applications and making grant announcements. As the scope of the audit did not extend to examining the merits of decisions taken by the Intelligent Island Board or Project Executive (neither being Australian Government bodies) to fund particular projects, the better practice criteria for selecting projects are not applicable to the Intelligent Island Program.*

#### Handling applications

**3.1** Successful grant programs can generate a high level of interest from potential applicants by using appropriate and effective promotion mechanisms to increase program awareness in target groups. Sufficient guidance should accompany application forms to assist applicants to provide all relevant information on all selection criteria. Grant-giving organisations should have a procedure for registering all applications received and a procedure for determining whether late applications should be accepted or rejected.

**3.2** The ANAO has assessed the performance of DCITA in handling applications for the programs subject to audit as:

BITS Incubator	ICT Incubators	BITS ANP	ANP2	BITS Intelligent Island	NCF	Towns over 500
✓✓	✓✓	✓✓	✓	na	✓✓	✓✓

- ✓✓ complies with better practice principle in all material respects
- ✓ partially complies with better practice principle, but with some room for improvement
- ✗ does not comply with better practice principle, with significant shortcomings
- na not applicable

**3.3** DCITA informed potential applicants to the *BITS Incubator*, *ANP* and *NCF* programs by advertising for, and holding, information sessions in most Australian capital cities. The information sessions were well attended. In respect of the *NCF Program*, DCITA also sent emails to all people who had previously registered interest in the program (on DCITA’s website) to let them know of the program’s launch. As the *NCF Program* involved the delivery of ICT for the benefit of education and health services in regional areas, the Australian Government Departments of Health and Aged Care; and

Employment, Training and Youth Affairs also notified their constituents to make them aware of the *NCF*.

**3.4** In respect of the *Towns over 500 Program*, the Minister approved DCITA's recommendation to put out a restricted tender to the three mobile telephone carriers with a current presence in regional areas. One tenderer submitted two tenders. The program's probity adviser indicated that the request for tender document did not restrict the submission of multiple tenders from tenderers.

**3.5** As the *ICT Incubators* and *ANP2* programs were targeted to existing grantees of the *BITS Incubator* and *ANP* programs, all were aware of the new programs.

**3.6** DCITA developed and applied appropriate criteria for accepting or rejecting late applications for the *ANP* and *NCF* programs. No late applications or tenders were received for the other programs subject to audit.

**3.7** As noted in *Producing program guidelines* above, the ANAO considers that DCITA developed comprehensive program guidelines and tender requirements for all programs subject to audit, except *ANP2*. The ANAO noted that the program guidelines and tender requirements were issued at the time of the calls for applications and tenders. The ANAO also found that potential applicants were all informed of any changes to, or clarification of, the program guidelines and tender requirements by way of notices posted on DCITA's website or by correspondence with those who had registered their interest in applying or tendering. DCITA appropriately registered the acceptance of each application by opening separate management files for each.

**3.8** Overall, the ANAO considers that DCITA promoted the programs subject to audit to potential applicants, informed them of the application requirements, and handled applications received in accordance with better practice. However, greater guidance to *ANP* grantees through program guidelines would have improved the quality of their submissions for further funding under *ANP2*.

## Appraising applications

**3.9** The measure of a good appraisal process is one that is transparent and that is likely to select those projects that best represent value for money in the context of the objectives and outcomes of the grant program.

**3.10** The ANAO has assessed the performance of DCITA in appraising applications for the programs subject to audit as:

BITS Incubator	ICT Incubators	BITS ANP	ANP2	BITS Intelligent Island	NCF	Towns over 500
✓✓	✓✓	✓✓	×	na	✓✓	✓✓

✓✓	complies with better practice principle in all material respects
✓	partially complies with better practice principle, but with some room for improvement
×	does not comply with better practice principle, with significant shortcomings
na	not applicable

### BITS Incubator, ICT Incubators, ANP and NCF programs

**3.11** The process for selecting projects in the *BITS Incubator*, *ICT Incubators*, *ANP* and *NCF* programs typically involved:

- an initial desktop assessment of applications for eligibility by DCITA officers (not applicable to the *ICT Incubators Program*);
- DCITA's assessment of applications against the merit-based selection criteria using a five-point rating scale;
- an assessment of some applications by technical consultants and/or other Australian Government departments against some of the selection criteria using the same five-point rating scale (not applied in the *ICT Incubators Program*);
- determining scores for each criterion of each shortlisted application by either averaging all the assessors scores or by DCITA reassessing applications after taking into account the assessment scores of others (not applicable to the *ICT Incubators Program*); and
- an assessment (including interviews) of a further shortlist by either a private sector expert advisory panel (*BITS Incubator*, *ANP* and *NCF* programs) or interdepartmental selection panel (*ICT Incubators Program*) using a pre-defined rating scale.

**3.12** DCITA shortlisted only the highest ranked proposals for further consideration by the Expert Advisory Panels or Selection Panel, with only one exception. The exception was one lower-ranked *BITS Incubator* proposal that was forwarded to the panel ahead of higher-ranked proposals on the basis of strong support for the proposal from a State Government. The ANAO considered that this was contrary to the published selection criteria. (Subsequently, the BITS Incubator Panel scored this proposal lower than others and it was not selected for funding.) The ANAO considers that better practice requires applications to be shortlisted in strict accordance with the published program guidelines and selection criteria to maintain the transparency of the selection process.

**3.13** The Expert Advisory Panels and Selection Panel recommended only the highest ranked proposals for funding to the Minister, with one exception. The exception was the *NCF Program* where the Panel canvassed two funding options: (i) fund the top eight projects; or (ii) substitute the ninth ranked application (from Tasmania) for one of the NSW proposals (ranked equal fourth). Option (ii) would allow a greater geographic spread of projects—resulting in one or more *NCF* projects in all States and Territories, except ACT. The *NCF* Panel justified, and subsequently recommended, option (ii) because:

- the difference between the scores of the two applications was small (76.7 versus 80.0 out of 100.0);
- of the four NSW applications ranked in the top eight applications, the NSW application flagged for possible substitution tied as the lowest ranked application from NSW; and
- of project diversity grounds as the NSW application flagged for possible substitution was from the NSW government (as were the top two ranked NSW applications selected for funding) as opposed to the only community-based NSW application, which was retained.

**3.14** The *NCF* program guidelines did not identify the geographic spread of projects as a potential selection consideration. However, the probity auditor considered that it could be taken into account as DCITA officers had advised at the public information sessions that it may be considered during project assessment. The ANAO considers that the transparency of the selection process could have been improved if program guidelines mentioned that the geographic spread of projects could be a selection consideration.

**3.15** On many occasions, the Panels recommended that successful proposals receive a different amount of funding than that requested.<sup>13</sup> The BITS Incubator Panel recommended that two proposals receive significantly more funding than was sought due to the high quality of their proposals, conservative levels of funding sought and their capacity to contribute to overall program objectives. Other projects of the *BITS Incubator Program* and all recommended ANP and NCF projects were recommended to receive either the same or less funding, sometime significantly less funding, than sought by the proposals.

**3.16** The ANP Panel was able to identify which features it did not want to fund or the specific impacts of reduced funding when it recommended the three ANP projects. Similarly, the NCF Panel recommended reductions to project funding sought by applicants by excluding specific items, creating ‘tighter’ budgets or scaling down the projects (for example, by reducing the number of towns covered). Reductions to the project funding sought under the *BITS Incubator Program* reflected an ability to scale down the projects—the details of which were to form part of the funding deed negotiations.

**3.17** The Minister approved all recommendations from the Expert Advisory Panels or Selection Panel for the *BITS Incubator*, *ICT Incubators*, ANP and NCF programs without exception. See Table 3.1 for the list of projects funded under these programs.

**3.18** The ANAO found that:

- the selection criteria targeted program priorities;
- all consultants and Expert Advisory Panel members had to abide by confidentiality and conflict of interest requirements;
- DCITA provided practical guidance to its assessors, its consultants, assessors from other Australian Government departments and Expert Advisory Panels to aid in the consistency of proposal scoring against each criterion;
- assessments were made in accordance with the program guidelines. The one exception was noted above—concerning the geographic spread of projects in the *NCF Program*;

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<sup>13</sup> This did not apply to the *ICT Incubators Program* as DCITA advised all eligible parties in advance that all selected projects would receive the same amount of funding.

- assessors ratings against each criterion for each application were generally well documented, along with the reasons for the rating. Exceptions were the *BITS Incubator* and *ANP* programs where although the Expert Advisory Panels documented a total score for each application it saw, documentation of the Panels' ratings against each criterion were not retained. DCITA advised that this occurred to protect the anonymity of Panel members' scores. The ANAO considers that because of this it was not possible to determine the relative merits of each application on a criterion-by-criterion basis as assessed by the Panel. This may have helped DCITA to negotiate better funding agreements as DCITA could have incorporated the highly desired features from some applications to the deed negotiations of others. The ANAO considers that members of future Advisory Panels should document their ratings against each selection criterion, either collectively or individually. If individually, the anonymity of members' ratings could still be protected by using a code rather than documenting the members' names; and
- the selection processes and documentation were approved by independent probity auditors who did not identify any probity issues relating to the programs' assessment and selection processes (not applied in the *ICT Incubators Program*).

## ANP2

**3.19** There was no documentation on file evidencing DCITA's critical assessment of the *ANP* grantees' submissions for further funding under *ANP2* (see *Designing programs for value for money* in Chapter 2 above). The ANAO considers that this assessment would have improved the advice provided to the Minister for funding grantees.

**3.20** DCITA forwarded the projects' funding recommendations, which were consistent with the amounts of funding requested by the grantees, to the Minister in May 2004. The Minister approved DCITA's proposed allocations for continued funding to the three *ANP* projects (see Table 3.1).

**Table 3.1**

**Projects funded under the programs subject to audit (in alphabetical order)**

BITS Incubator	BITS ANP	NCF
<ul style="list-style-type: none"><li>• Allen &amp; Buckeridge Seed Stage Ventures (NSW) \$5m</li><li>• Australian Distributed Incubator (Vic) \$7m</li><li>• Bluefire Group Incubator (NSW) \$6m</li><li>• Entrepreneurs in Residence (WA) \$10m</li><li>• Epicorp (ACT) \$8m</li><li>• Information City Victoria (Vic) \$8m</li><li>• InQbator (Qld) \$9.5m</li><li>• ITEM3 (NSW) \$7.37m</li><li>• Original IT Investments (NT) \$5m</li><li>• Playford Capital (SA) \$10m</li></ul>	<ul style="list-style-type: none"><li>• Centre for Networking Technologies for the Information Economy (CeNTIE) \$14m</li><li>• Grid And Next Generation Network (GrangeNet) \$14m</li><li>• m.Net Corporation \$9.23m</li></ul>	<ul style="list-style-type: none"><li>• Grampians Rural Health Alliance Network (Vic) \$8m</li><li>• Health and Education Information Access for Rural and Regional NSW \$3.5m</li><li>• Network WA \$8m</li><li>• Northwest and New England Broadband Telecommunications Network (NSW) \$5.5m</li><li>• NSW and NT Interactive eLearning Initiative \$8m</li><li>• Outbacknet@qld \$8m</li><li>• Regional Network Delivering Educational Services (SA) \$6m</li></ul>
ICT Incubators	ANP2	
<ul style="list-style-type: none"><li>• Australian Distributed Incubator (NSW/Vic) \$4.57m</li><li>• Divergent Capital (formerly Bluefire Group Incubator) (NSW) \$4.57m</li><li>• Entrepreneurs in Residence (WA) \$4.57m</li><li>• Epicorp (ACT) \$4.57m</li><li>• Information City Australia<sup>a</sup> (NSW/Vic) \$4.57m</li><li>• InQbator (Qld) \$4.57m</li><li>• In-tellinc<sup>b</sup> (Tas) 4.57m</li><li>• Playford Capital (SA) \$2.14m<sup>c</sup></li></ul>	<ul style="list-style-type: none"><li>• Centre for Networking Technologies for the Information Economy (CeNTIE) \$10.1m</li><li>• Grid And Next Generation Network (GrangeNet) \$4.1m</li><li>• m.Net Corporation \$5.8m</li></ul>	<ul style="list-style-type: none"><li>• Tasmanian Health and Education Communications Consortium \$3m</li></ul>

Source: DCITA

a — Formed by the merger of Allen & Buckeridge Seed Stage Ventures and Information City Victoria.

b — In-tellinc was originally funded under the BITS *Intelligent Island Program* and was eligible for consideration for further funding under the *ICT Incubators Program*.

c — Playford Capital received lesser funding than other incubators due to the significant carry forward of unspent *BITS Incubator Program* funds.

## Towns over 500 Program

**3.21** The selection process for the *Towns over 500 Program* involved assessments by DCITA officers and technical consultants of the three tenders lodged by two carriers. An Assessment Panel (comprising two executives from DCITA)<sup>14</sup> considered that all tenders had some areas of non-compliance with the RFT, but there was no significant area of non-compliance. The Panel found that the Telstra B offer to provide CDMA coverage to all 136 towns for \$31.2 million represented the best value for money because it best met the RFT's selection criteria, provided additional GSM coverage to many of the towns at no additional cost to the Australian Government, offered a faster rollout than the other tenderer's offer and was the only offer to provide mobile phone coverage to all towns listed in the RFT. The Panel recommended accepting the Telstra B offer, but asked the Minister to consider whether or not to include the four very high cost towns in NT that would cost many millions of dollars.

**3.22** The Minister approved approaching Telstra and negotiating a new offer for coverage of 132 towns (that is, excluding the four very high cost towns in NT). The Government later established the Telecommunications Action Plan for Remote Indigenous Communities (TAPRIC) to separately address the needs of the four very high cost towns in NT excluded from the *Towns over 500 Program*.<sup>15</sup>

**3.23** The ANAO found that:

- the selection criteria targeted program priorities;
- all consultants had to abide by confidentiality and conflict of interest requirements;
- assessments were made in accordance with the RFT;
- ratings against each criterion for each tender were documented, along with the reasons for the rating; and

<sup>14</sup> An executive from the Department of Transport and Regional Services was originally part of the panel. However, she resigned her position before the panel could complete its task. There was insufficient time to find a replacement. The probity adviser agreed with the Assessment Panel to proceed with only two DCITA executives. Tenderers were also advised of this change and no objections were received.

<sup>15</sup> The TAPRIC program was not examined in this audit.

- the selection process and documentation were approved by an independent probity adviser who did not identify any probity issues relating to the programs' assessment and selection process.

# Conclusion

**3.24** For all programs subject to audit except *ANP2*, the ANAO considers that DCITA appraised the applications and tenders consistently and fairly and in accordance with better practice. The appraisals were in line with the program guidelines or RFT documentation and selection criteria, resulting in the selection of the highest rated applications and tender. Decisions, and reasons for decisions, were generally well documented, except in respect of *ANP2*. There was insufficient documentation available for the ANAO to assess the quality of DCITA's appraisal of *ANP2* submissions.

# Making grant announcements

**3.25** From a program administration perspective it is preferable for all decisions on approved and unsuccessful projects to be announced together, or within a relatively short period of time. This approach enables proponents to know the outcome of their proposals as soon as possible so they can begin implementing their projects or pursue alternative sources of funding.

**3.26** The ANAO has assessed the performance of DCITA in announcing grants for the programs subject to audit as:

BITS Incubator	ICT Incubators	BITS ANP	ANP2	BITS Intelligent Island	NCF	Towns over 500
✓✓	✓✓	✓✓	✓✓	na	✓✓	✓✓

- ✓✓ complies with better practice principle in all material respects
- ✓ partially complies with better practice principle, but with some room for improvement
- ✗ does not comply with better practice principle, with significant shortcomings
- na not applicable

**3.27** For all programs subject to audit, letters of offer were sent to the successful applicants and tenderer shortly after the Minister approved them.

**3.28** In respect of the *BITS Incubator*, *ICT Incubators*, *ANP* and *NCF* programs, the Minister or Prime Minister publicly announced the successful applicants shortly thereafter, after the successful applicants confirmed their in-principle agreement to their projects proceeding (particularly when they were offered reduced funding). As there was no funding retained for second rounds

of applications, by inference, all unsuccessful applicants for these programs were informed at the same time. DCITA also sent letters to unsuccessful applicants. DCITA provided prompt, relevant feedback to unsuccessful applicants, when requested.

**3.29** There were no unsuccessful applicants under *ANP2*. The two unsuccessful incubators under the *ICT Incubators Program* were advised at the same time as the successful incubators.

**3.30** The unsuccessful tenderer for the *Towns over 500 Program* was notified at the conclusion of the contract negotiations with the preferred tenderer, some 2½ months after the identification of the preferred tenderer. This was done on the basis that the other tenderer could be approached should contract negotiations fail with the preferred tenderer. Telstra was announced as the successful tenderer after the signing of the contract with DCITA.

**3.31** For all programs subject to audit, the ANAO considers that DCITA adopted sound practice by making grant or contract offers to successful applicants and the successful tenderer, and advised unsuccessful applicants and the unsuccessful tenderer, within reasonable times of selection decisions.

# 4. Managing and Monitoring Funding Deeds

*This chapter assesses DCITA’s performance in establishing funding deeds and monitoring the performance of grantees against deed requirements in compliance with better practice principles.*

## Establishing funding deeds

**4.1** Well-drafted formal agreements are necessary for the effective management of grants. Experience has shown that better practice funding deeds or contracts are more likely to lead to better results and minimise ongoing monitoring effort. Formal agreements should protect the Australian Government’s interests by ensuring that public money is used for the intended purpose, defining project deliverables, scheduling payments (according to progress), and specifying progress reporting requirements and acquittal procedures.

**4.2** The ANAO has assessed the performance of DCITA in establishing funding deeds, MOUs and contract for the programs subject to audit as:

BITS Incubator	ICT Incubators	BITS ANP	ANP2	BITS Intelligent Island	NCF	Towns over 500
✓✓	✓	✓✓	✓	✓✓	✓✓	✓✓

- ✓✓ complies with better practice principle in all material respects
- ✓ partially complies with better practice principle, but with some room for improvement
- × does not comply with better practice principle, with significant shortcomings
- na not applicable

## Incorporating assessment knowledge

**4.3** Expert Advisory Panels and Selection Panels accumulate much knowledge of the applications they recommend for funding. It is therefore advantageous for assessors to impart their knowledge to those responsible for negotiating funding deeds. In this way, the highly desired generic features from some applications can be incorporated into the deed negotiations of others.

**4.4** The Expert Advisory Panels for the *BITS Incubator*, *ANP* and *NCF* programs recommended that general and specific issues be considered during

funding deed negotiations. General issues were those relevant to all recommended projects of each program, while specific issues related to particular projects. The ANAO found that DCITA had acted upon the recommended conditions during deed negotiations with successful applicants.

**4.5** In respect of the *ICT Incubators Program*, the ANAO questioned the merits of setting low standardised co-investment targets for incubators who use widely varying models of incubation. The ANAO considers that this may have impacted adversely on maximising the value for money from the program. This issue is further discussed in *Designing programs for value for money* in Chapter 2.

**4.6** As noted earlier, there was no documentation on file evidencing DCITA's critical assessment of the *ANP* grantees' submissions for further funding under *ANP2*. Therefore the extent to which the highly desired features from some *ANP2* submissions were incorporated into the deed negotiations of others is not clear.

**4.7** Under the *Intelligent Island Program*, the Australian and Tasmanian Governments negotiated MOUs, which were not legally binding. The MOUs established the Intelligent Island Board (containing Australian Government membership) and, later, the Project Executive (which included DCITA representation) whose function was to establish and implement the Intelligent Island Implementation and Business Plans. The Plans specified draft performance indicators for the *Intelligent Island* initiatives or outputs, which were to be reported on regularly. The ANAO considers that the MOUs established adequate control measures for DCITA to regularly monitor the performance of the program.

**4.8** The Selection Panel for the *Towns over 500 Program* identified a number of issues that would require resolution during contract negotiations with the preferred tenderer. Their satisfactory resolution was aided by the Selection Panel members being responsible for contract negotiations with the preferred tenderer.

## **Use of technical advice**

**4.9** Financial or technical consultants assisted DCITA with the *BITS Incubator*, *NCF* and *Towns over 500* programs during deed and contract negotiations to ensure the contents of successful applications and the successful tender were accurately reflected in the funding deeds and contract.

DCITA also engaged external legal advisors to develop standard funding deeds for the *BITS Incubator* and *ANP* programs to address the particular risks the programs' posed.

**4.10** The *NCF Program* also required successful grantees to submit their request for tender documents to engage a telecommunications carrier (the key requirement to deliver the projects) to DCITA for vetting by technical consultants before release. This ensured that the projects' tender specifications matched the requirements of the selected applications.

**4.11** The ANAO considers that obtaining internal or external technical advice is one means of managing the risk that the specifications from complex applications and submissions may not be fully and accurately transferred to the funding deeds. The benefits of obtaining technical advice should be assessed on a case by case basis.

**4.12** DCITA indicated, and the ANAO agreed, that its experience with the *BITS Incubator Program* meant that technical advice from outside of the department was not necessary to ensure that successful applications under the *ICT Incubators Program* were translated accurately into the funding deeds.

**4.13** DCITA did not engage external technical consultants during funding deed negotiations for the *ANP* and *ANP2* programs. DCITA indicated that it was not aware of any problems in this area and that there was sufficient in-house expertise in the area negotiating the *ANP* deeds, including people with high level engineering and science degrees.

**4.14** The nature of the *Intelligent Island* agreement meant that technical advice was not necessary to establish the MOUs between the Australian and Tasmanian Governments.

## **Timeliness of funding deed negotiations**

**4.15** Delays in finalising deeds and contracts can impede the timely achievement of program objectives. Therefore responsible departments should actively manage this time to ensure that delays are minimised. The ANAO noted that one or more projects from the *BITS Incubator*, *ICT Incubators*, *ANP*, *ANP2* and *NCF* programs took significant amounts of elapsed time to negotiate. Time periods between letters of offer and deed signing for the programs ranged from four months to over one year. In respect of the *NCF Program* in particular, the ANAO considers DCITA could have worked more actively to finalise some of the deeds.

**4.16** DCITA agrees that delays are undesirable when negotiating funding deeds. However, it considers that delays can be unavoidable to achieve program outcomes and protect the Australian Government's interests—particularly when alternative grant recipients do not exist in the market. DCITA considers that it actively managed the finalisation of funding deeds for programs subject to audit to ensure that delays were minimised as much as possible. DCITA's standard agenda for the first deed negotiation session with all recipients included a timetable for the negotiation and signing of the deeds. DCITA also considers that many of the delays noted by the ANAO were not caused by a lack of activeness on DCITA's part, but by other factors out of DCITA's control. Examples include changes to State Ministers or state departmental reorganisations. Furthermore, DCITA's records do not formally document all the contacts made between DCITA and grantees to progress the deed negotiations. In any event, the deed signing delays led to only small delays in completing projects within the programs' original timeframes.

**4.17** The ANAO observed that although DCITA quickly processed its information during the negotiations, it too often accepted the open-ended timeframes for grant recipients to process their information. To better manage the risk to the timely achievement of program objectives, DCITA could have, in consultation with the grant recipients, set *and updated* negotiation timetables and milestone events with due dates for the latter's completion. If these were documented and agreed to by the senior management of the grant recipients, it may have given DCITA greater leverage to urge grant recipients to finalise negotiations in a timely manner.

## **Project risk management**

**4.18** Risk management forms an integral part of program and project management, albeit informally if not formally. However, the ANAO considers that the complexity involved in the *BITS Incubator*, *ICT Incubators*, *ANP*, *ANP2* and *NCF* projects strengthens the need for sound, ongoing formal risk management at the project level. To manage some project risks, DCITA has instituted appropriate management controls, including developing and applying procedure manuals (see *Establishing monitoring arrangements* in this chapter below) and requiring grantees to report regularly against project milestones. However, this does not obviate the value of a formal and coordinated approach to managing project risks.

**4.19** The ANAO considers that improved project risk management may have assisted DCITA to better manage one of the *BITS Incubator* projects. The prospects of one incubator's success was hindered from the start when a consortium member, integral to the incubator's planned operations, suddenly pulled out of its (non-legally binding) Heads of Agreement with the incubator.<sup>16</sup> Improved project risk management could have identified possible risk treatments such as:

- incorporating mechanisms in the funding deed to allow DCITA to review the value of continuing to fund the incubator; and
- asking the incubator to consider and identify, in advance, other potential consortium members who could fill the potential void.

**4.20** The ANAO notes that monitoring grantees against project milestones did not, and could not be expected to, identify and manage the risk of a consortium member pulling out of an incubator as described above.

## Recommendation No.2

**4.21** The ANAO recommends that DCITA require grantees who receive grants for complex or high risk operations to:

- (a) develop a risk management plan at the start of the grant;
- (b) regularly and formally monitor and manage the project's risks; and
- (c) report regularly to DCITA (at least on an exceptions basis) on the project's management of identified higher priority risks.

### *DCITA response*

**4.22** DCITA agrees and will incorporate these requirements in the guidelines of relevant programs, while also noting that the introduction of such a measure should be undertaken having regard to relevant Government policies and directions, such as the use of standardised funding agreements.

## Project sustainability

**4.23** The sustainability (or ongoing financial viability) of the funded projects after the conclusion of grant programs was a consideration for all the programs subject to audit, except *Intelligent Island* (where this was more a consideration

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<sup>16</sup> It is likely that the incubator was not in a sufficiently strong negotiating position to channel the consortium partner's commitments through a legally-binding agreement.

for the Intelligent Island Board and Project Executive). Project sustainability was either one of the official objectives of the programs (as it was in the *BITS Incubator*, *ICT Incubators* and *NCF* programs) or was an explicit consideration during application or tender assessment (*ANP*, *ANP2* and *Towns over 500* programs).

**4.24** The ANAO found that project sustainability was handled well in the *ANP2*, *NCF* and *Towns over 500* programs but not as well in the *BITS Incubator*, *ICT Incubators* and *ANP* programs.

*Project sustainability and the ANP2, NCF and Towns over 500 programs*

**4.25** The ANAO noted that *NCF* funding deeds did not directly mention the desire for the projects to be sustainable in the longer term without further *NCF* funding. However, the project budgets identified significant cash and in-kind contributions from non-Australian Government sources (primarily from the *NCF* grantees) in the years beyond the life of the *NCF Program*. The ANAO considers that this provides support for the grantees' intentions for their projects to be sustainable in the medium to longer term.

**4.26** A key provision of the Government's decision to establish *ANP2* was that funding would be allocated to projects subject to the development of strategies to reduce their dependence on government funding. To this end, DCITA introduced conditions and milestones into the *ANP2* funding deeds so that each project would develop and implement strategies, during the *ANP2* funding period, to assist with becoming sustainable without further Australian Government funding. As well as being covered in the projects' final reports, each project is required to submit a report in 2005 or 2006 on its prospects for becoming sustainable without further Australian Government funding.

**4.27** DCITA indicated that it received assurance of the sustainability of the services funded under the *Towns over 500* contract between DCITA and Telstra in two respects. First, Telstra would not have tendered for the program had it thought that the services to towns would not be viable (after receiving a government contribution to their capital cost). Second, key contractual requirements to deliver the services under the *Towns over 500 Program* have been incorporated in Telstra's licence conditions for at least a period of five years after the end of the contract.

## *Project sustainability and the BITS Incubator, ICT Incubators and ANP programs*

**4.28** The ANAO recognises the experimental nature of the *BITS Incubator* and *ICT Incubators* programs meant that some of the incubator business models would be successful while others could encounter difficulties in becoming self-sustainable. Nevertheless, the ANAO found little in the way of financial and performance targets in the BITS and ICT Incubators funding deeds to encourage the incubators along the path to self-sustainability. The primary means for incubators to become financially self-sustaining is to generate sufficient revenue from dividends, exits and services revenue and/or foster the creation of a private investment fund or incubator seed fund of sufficient size to fund the incubator's on-going investment and operating activities. Other means of self-sufficiency could include raising and managing funds, undertaking related lines of business such as consultancies and obtaining funding from other government programs. DCITA's monitoring of ICT incubator sustainability is limited to the incubators reporting annually on the extent to which they have achieved self-sustaining operations.

**4.29** Although a relevant factor in the *BITS Incubator Program*, the ANAO considers that the importance of project sustainability increased under the latter *ICT Incubators Program*. Part of the justification for the program extension was the finding by the *BITS Incubator* evaluation report that 7-8 years is a more realistic timeframe for technology incubators to become established. The extension of the *BITS Incubator Program* through the *ICT Incubators Program* gave the incubators a total of 8-9 years of Australian Government funding.

**4.30** However, the ANAO found that:

- no incubator appears to have committed to revenue targets from dividends, exits and services revenue sufficient for the incubator's self-sustainability;<sup>17</sup>
- none of the ICT incubator owners is using their own money to establish seed investment funds (with most collectively providing less than \$1 million in cash and in-kind contributions for their incubators' operating expenses) compared to government funding of \$4.57 million for most incubators;

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<sup>17</sup> One incubator is required to generate \$150 000 from dividends, exits and services revenue. However, this, by itself, would not be sufficient for the incubator's survival.

- only two of the eight incubators have committed to establishing private investment funds of any great size (that is, in the millions of dollars); and
- DCITA is not monitoring the extent to which the incubators are undertaking other relevant activities, such as consultancies, to build a base on which to help sustain their operations.

**4.31** DCITA states that incubator self-sustainability was only one of the four or five objectives of the *BITS Incubator* or *ICT Incubators* programs, respectively. DCITA also considers that the funding agreements encourage incubator sustainability by requiring incubators to have exits by the fourth year, to raise other contributions and, for some, to raise capital funds to administer. Given the timeframe of the program and the nature of companies being funded, revenue from dividends is likely to be negligible and therefore not a good measure given the long lead times involved in bringing a start-up company to being so cash positive that it can make distributions to shareholders.

**4.32** In respect of the *ANP*, project sustainability, while not an official program objective, was a factor considered during the assessment of applications. The ANAO found that the only mention of project sustainability in the *ANP* funding deeds was that the projects should report annually on their prospects for sustainability at projects' end. However, the ANAO found that none of the annual reports for the CeNTIE project accepted by DCITA to date have reported on this matter. DCITA indicated that project sustainability was a greater consideration under *ANP2*.

**4.33** The ANAO considers that had project sustainability received a higher profile, DCITA could have asked grantees to nominate sustainability measures and targets they considered appropriate. Incorporating these into the deeds does not guarantee their achievement or the longer-term viability of the incubators. However, they do provide benchmarks against which the grantees would formally and regularly report their progress on to DCITA.

## Conclusion

**4.34** The ANAO considers that, given the complexity of the projects funded, DCITA established funding deeds, MOUs and contract under the *BITS Incubator*, *ANP*, *Intelligent Island*, *NCF* and *Towns over 500* programs in compliance with better practice principles. However, the quality of some funding deeds could have been improved had DCITA:

- tailored challenging but achievable performance targets for each ICT incubator rather than using standardised targets;
- better taken into account measures to aid the ICT incubators along the path to longer-term self-sustainability; and
- documented its critical assessment of the *ANP* grantees' submissions for further funding under *ANP2*.

## Establishing monitoring arrangements

**4.35** A well-drafted formal agreement alone is not sufficient to ensure the objectives of grants are met. Funding agreements need to be supported by performance and financial monitoring frameworks informed by an analysis of the risks involved.

**4.36** The ANAO has assessed the performance of DCITA in establishing project monitoring arrangements for the programs subject to audit as:

BITS Incubator	ICT Incubators	BITS ANP	ANP2	BITS Intelligent Island	NCF	Towns over 500
✓✓	✓✓	✓✓	✓✓	✓	✓✓	✓✓

- ✓✓ complies with better practice principle in all material respects
- ✓ partially complies with better practice principle, but with some room for improvement
- × does not comply with better practice principle, with significant shortcomings
- na not applicable

**4.37** The funding deeds, MOUs and contract of the programs subject to audit established the formal grantee monitoring arrangements, including for grantees to provide DCITA with:

- proposed carrier tender documents so that DCITA could conduct a specification review of them to ensure that it meets project requirements (applied to the *NCF Program*);
- carrier tender evaluation reports, or certification that the carrier selected met the requirements of the tender (*NCF Program*);
- quarterly or six-monthly reports on project activity, including achievement of milestones and income and expenditure during the reporting period (and budgeted income and expenditure for the following period) (all programs subject to audit);

- annual reports containing independently audited financial reports (all programs subject to audit, except for *Towns over 500* where Telstra would provide an audited financial report at the conclusion of the contract); and
- a self-contained final report at the end of the grant period (all programs subject to audit, except *Intelligent Island* and *Towns over 500*).

**4.38** DCITA developed procedures manuals to assist its staff to monitor the the *BITS Incubator*, *ICT Incubators*, *NCF* and *Towns over 500* programs. (DCITA indicated that the same staff administered the *NCF* and the *ANP* and *ANP2* programs and they used the *NCF* procedures manual to administer all due to their very similar administrative processes and procedures.) As well as providing background information on the programs, the manuals typically outlined:

- the general role of the DCITA in managing the program, plus the specific roles, responsibilities, delegations and approvals of Branch members;
- the key legislative and departmental documents that frame DCITA's monitoring of the projects;
- the maintenance of files and general administrative practices (which emphasise the need for thorough documentation);
- the payment process;
- monitoring of milestones;
- quarterly, annual and final reporting requirements of grantees and the analysis of them required of DCITA;
- managing variations to the funding deeds or contracts and schedules;
- funding deed or contract termination issues; and
- interim and final program evaluation requirements.

**4.39** The ANAO considers that the procedures manuals provide valuable advice to those responsible for monitoring the programs, particularly where staff changes occur during the lives of the programs.

**4.40** DCITA indicated that it intends to develop a procedures manual for the remainder of the *Intelligent Island Program*. It will be based on the framework for such manuals outlined in DCITA's *Practical Guide for Program*

*Administration* (2005). The framework covers detailed monitoring and assessment procedures, the roles and responsibilities of departmental officers and preparing and varying funding agreements.

**4.41** With the small number of projects to manage under the programs subject to audit (ranging from one to ten projects per program) and the DCITA personnel available to monitor them, DCITA maintained regular contact with grantees through telephone conversations, emails and, at times, face-to-face meetings, throughout the programs’ lives.

**4.42** DCITA established generally well-maintained management files for all programs subject to audit (including separate files for each project) and centrally monitored the payments made to projects. The ANAO considers that this management information system was appropriate for all the programs subject to audit.

**4.43** Many of the management controls incorporated into all programs subject to audit are in accordance with the generic grant management controls outlined in past and current DCITA Fraud Control Plans and Fraud Risk Assessments (usually conducted and updated every two years).

**4.44** The ANAO considers that DCITA established sound practices to monitor the performance of the projects within all programs subject to audit except *Intelligent Island*. The monitoring framework for the *Intelligent Island Program* will be enhanced once its planned procedures manual is developed.

**Monitoring progress and payments**

**4.45** Performance monitoring determines the extent to which desired outcomes have been achieved, while financial monitoring determines whether the relevant funding accountability procedures have been complied with.

**4.46** The ANAO has assessed the performance of DCITA in monitoring project progress and payments for the programs subject to audit as:

BITS Incubator	ICT Incubators	BITS ANP	ANP2	BITS Intelligent Island	NCF	Towns over 500
✓	✓✓	✓✓	✓✓	✖	✓✓	✓✓

- ✓✓ complies with better practice principle in all material respects
- ✓ partially complies with better practice principle, but with some room for improvement
- ✖ does not comply with better practice principle, with significant shortcomings
- na not applicable

## General comments

**4.47** The ANAO found that, overall, DCITA has thus far ensured that *BITS Incubator*, *ICT Incubators*, *ANP*, *ANP2* and *NCF* projects, and the contractor for the *Towns over 500 Program* have met their reporting requirements. DCITA also assessed the projects' performance, before making progress payments, in accordance with the funding deeds or contract. Where appropriate, DCITA has withheld payments where grantees already have sufficient funding to cover planned expenditure over the next reporting period. DCITA has also made partial payments to Telstra to recognise partial performance under the *Towns over 500* contract. The ANAO also noted instances where DCITA followed-up report inconsistencies and/or unclear expression with the grantees or contractor until the issues were satisfactorily resolved.

**4.48** The ANAO considers that all programs subject to audit except one has effectively achieved their respective objectives. The objective at greatest risk of not being achieved is the sustainability of the *BITS* and *ICT* incubators after government funding is exhausted (see *Establishing funding deeds* in this chapter above). The mid-term reviews or evaluations of the *BITS Incubator*, *ANP* and *NCF* programs provide assurance of the performance of these programs (see *Carrying out the program reviews* in Chapter 5 below). Projects under *ICT Incubators* and *ANP2* programs, whose objectives are similar to their predecessor programs, are meeting their milestones and performance targets. Telstra has effectively delivered the contracted services under the *Towns over 500 Program*. However, significant delays to the *Intelligent Island Program* have resulted from a number of outstanding issues that will need to be resolved before the program could be considered to be on track to achieve its objectives (see below for further discussion).

**4.49** Particular challenges of note faced by DCITA in the *BITS Incubator*, *Intelligent Island*, *NCF* and *Towns over 500* programs are discussed below.

## BITS Incubator Program

**4.50** Of particular note during the implementation of the *BITS Incubator Program* were:

- the impact of the significant decline in *ICT* share values;
- overlooked funding deed milestones;
- waivers of or changes to generic clauses in deeds for some projects and not others;

- the handling of particular ‘conflict of interest’ issues; and
- the handling of a variation for one funding deed.

#### *Impact of the significant decline in ICT share values*

**4.51** At the time of the *BITS Incubator Program* selection process, ICT stocks (the ‘dot.coms’) were booming world-wide—particularly in the United States. It was in this climate that the program applicants drafted their incubator business plans and financial targets. However, in April 2000, just after the selection of incubator centres, technology stocks rapidly fell out of favour with the market.

**4.52** The significant decline in ICT share values (also known as the ‘tech wreck’) had a major adverse impact on the incubators and their business models. Incubator centres had problems getting the expected co-investment in their incubator centres or incubatees, resulting in a general downgrading of expected financial returns from incubator operations. Incubators considered that external funding issues would not be solved without incubators establishing track records that attract prospective investors. Also adversely impacting the financial models of incubators was that it was generally taking longer and costing more to get start-ups investor-ready than their original business models envisaged.

**4.53** Seven of the 10 incubators varied their business models and/or milestones (with DCITA’s approval) within two years of commencing operations to reflect market changes. Targets for numbers of incubatees, graduates and exits were generally revised downwards across the board, at the request of the incubators.<sup>18</sup> The independent evaluation of the *BITS Incubator Program* (dated November 2003) noted that ‘after the “tech wreck”, the instability of the capital markets means that there is little or no exit strategy available for an Incubator’s investments, hence there is no way to recoup cash to generate working capital for sustaining day-to-day incubator operations’.

#### *Overlooked funding deed milestones*

**4.54** The ANAO noted occasions where some milestones for at least two BITS incubators appear to have been overlooked or noted as missed when DCITA assessed incubator compliance with the funding deed. This possibly

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<sup>18</sup> Incubatees are start-up companies accepted by the incubators for incubation. Graduates are incubatees who have completed their period of incubation by meeting the milestones set out in their agreement with the incubator. Exits are divestments of the equity investments made by incubators in incubatees, which can also include incubatee liquidations.

reflected changes to the incubators' operations making these unassessed milestones irrelevant or of lesser importance than at the time of the deeds' signing. The ANAO considers that DCITA's assessments of grantee performance should formally document those milestones that are no longer relevant, with appropriate justification. Further, if the changes to milestones are significant, DCITA should consider the need to take them into account in a variation to the funding deed. DCITA indicated that formal variations to funding deeds occurred only when there were substantive changes.

#### *Waivers of or changes to generic clauses in some deeds*

**4.55** The ANAO noted that two incubators approached DCITA requesting a lifting of the generic restriction on the use of short-term convertible notes to invest in incubatees.<sup>19</sup> DCITA granted their requests and decided that it would grant the same request to other incubators who asked for it. The ANAO considers that, in the interest of treating all incubators equitably, DCITA should have informed all incubators of the opportunity to vary their deeds on this matter. DCITA indicated to the ANAO that, under the *ICT Incubators Program*, it is now policy to inform incubators that changes to generic conditions are available to all.

#### *Conflicts of interest issues*

**4.56** The *BITS Incubator* funding deeds contained conflict of interest provisions that, among other things, require grantees to notify DCITA of any conflict or risk of conflict and take all necessary steps to remove the conflict. Further, grantees or related parties must ensure that they do not engage in any activity or obtain any interest likely to conflict with the deed.

**4.57** In 2004, one incubatee alleged that a conflict of interest occurred when its incubator made an investment in a start-up company a couple of years earlier in which a board member and parties related to them had an existing interest. DCITA considered that there was little likelihood of an actual breach of the funding deed requirements as the deed's conflict of interest provisions related only to 'Grantees' (that is, the incubators) and not to consortium members, who formed part of the incubator's Board, or independent board members. Consequently, DCITA would have had no power under the deed to impose any condition or sanction on the incubators for what could otherwise be determined as conflict of interest situations. DCITA is not aware of the

<sup>19</sup> A convertible note is a debt security that can be converted into a predetermined amount of a company's equity at certain times in its life, usually at the discretion of the noteholder.

extent to which incubators invested in companies in which board members or related parties had an existing interest.

**4.58** The ANAO considers that this situation highlighted a gap in the coverage of the conflict of interest provisions of the *BITS Incubator* funding deeds. DCITA indicated that the conflict of interest clauses were based on standard requirements at the time and that internal and external legal advice was obtained in drafting the funding deeds. In any event, this gap has now been closed under the later *ICT Incubators Program*. *ICT Incubators* funding deeds specifically deem a conflict to exist if the incubator acquires an interest in an incubatee in which the incubator's management personnel (including Board members), officers and/or employees have a legal or substantial holding, or are employees or officers.

*Variation to one BITS Incubator funding deed*

**4.59** The ANAO noted that a funding deed variation for one of the BITS incubators was finalised only some four months before the four-year project was to finish. For the two preceding years, the incubator concerned had indicated its intention of lodging a request to vary its performance targets downwards for a number of reasons. However, the incubator did not make a variation request until 19 months after the original notification. By this stage, DCITA had little choice but to vary the milestones and performance requirements to match actual performance, which was significantly below original expectations. From the start of this incubator, its performance was progressively just below deed expectations (in terms of numbers of incubatees and graduates) for the first two to three years. However, the significant delays to graduate incubatees and its failure to obtain any private investment in the first two years of the incubator's operation (against a target of \$350 000) should have prompted DCITA into action. The ANAO considers that DCITA could have been more active in getting the incubator to lodge a deed variation request earlier.

**4.60** The need for a variation to the funding deed gained momentum when in the final year of the project, the incubator's consortium members informed DCITA that they had decided not to contribute further funding to the incubator. At that time, the funding deed required the incubator's consortium members to contribute a further \$825 000. The consortium requested that the requirement for its members to make further contributions be waived, while requesting that DCITA contribute its final payment of \$400 000. The incubator saw DCITA's final payment as essential to maintain its operations (at least to

the official end date for the project) and to give its incubatees the best prospects of success.

**4.61** DCITA considered that given the quantum of funding the incubator would receive and the performance of other indicators, the performance of the incubator concerned seemed within the bounds of acceptability. Following guarantees that the incubator would ensure that \$300 000 of the DCITA's final payment went directly to incubatees, DCITA agreed to make its final payment of \$400 000 and agreed to waive the \$825 000 due from the incubator's consortium members. After DCITA's final payment, the incubator received no further government funding and, in effect, became a passive holding company. To January 2006, this incubator had not had a successful incubatee exit.

**4.62** The ANAO questions the value to the program of DCITA's final payment of \$400 000 to the incubator. The unwillingness of its consortium members to contribute their full, previously agreed, commitment could be reasonably interpreted as a sign that they believed they were unlikely to obtain a commercial return on their incubator investment. This raises the ongoing viability of the incubator, a key program objective, to the fore. DCITA's final payment was unlikely to adequately address the incubator's ongoing viability. DCITA indicated that there was a strong Government commitment to have an incubator in every mainland State or Territory and that, in addition to sustainability, there were other equally important program objectives.

## Intelligent Island Program

**4.63** Of particular note in respect of the *Intelligent Island Program* were the delays to the program's implementation and the monitoring of the program's performance.

### *Delays to the Intelligent Island Program*

**4.64** The *Intelligent Island Program* has experienced significant delays throughout its life. The five-year program was originally due to be completed by June 2004, but will now be extended to June 2011. Of the \$40 million disbursed to the Tasmanian Government under the program, only \$12.8 million (32 per cent) had been expended to March 2006.

**4.65** From the outset of the program in mid-2000, DCITA held reservations about the resources devoted to the Secretariat supporting the program (which were provided by the Tasmanian Government). In August 2001, DCITA informed the Minister that implementation of the *Intelligent Island Initiatives*

(except the incubator initiative) were well behind schedule for various reasons beyond DCITA's control. The Minister met with the Tasmanian Premier shortly thereafter to progress the program. Nevertheless, DCITA considered that it could not remedy the problems with the delivery of the program without taking a more active role in each of the initiatives, but it did not have the resources or a mandate under the program's MOUs to do so. DCITA considered that if it was not possible for these issues to be addressed, the ability of the program to achieve its desired objectives appeared limited.

**4.66** Between 2002 and 2004 inclusive, DCITA's files make little mention of the slow progress in the program's implementation. Although, DCITA assisted the Secretariat to help progress some of the initiatives, little substantive progress was made on many initiatives. It was not until late 2005 that correspondence between Australian and Tasmanian Government Ministers proposed a way forward. The ANAO considers that earlier action to address the continual delays with the Intelligent Island Program may have improved its progress.

**4.67** DCITA indicated that its capacity to expedite the implementation of the *Intelligent Island Program* was affected by:

- the governance structure and DCITA's arm's length role in program administration;
- the capacity building nature of the program; and
- the complexities of establishing the Centre of Excellence.

#### *Performance monitoring of the Intelligent Island Program*

**4.68** The Implementation Plan for the *Intelligent Island Program* approved in August 2000 contained a set of performance indicators for each of the seven initiatives. However, the program has never reported the performance of the initiatives against these performance indicators.<sup>20</sup> Before receiving the first progress report for the program, DCITA considered that the performance indicators were of 'dubious quality' and only some of them usefully measured the performance of some of the initiatives. Consequently, DCITA did not follow-up with the Secretariat the absence of performance measurements against the indicators in the Program's six-monthly reports.

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<sup>20</sup> However, the ANAO acknowledges that the Incubator initiative came under the purview of the performance measures for the *ICT Incubators Program* from July 2004.

**4.69** In March 2003 an updated Intelligent Island Business Plan was drafted. It included performance indicators and baseline measures for each program output, which were linked to program outcomes. Although this draft Plan was submitted to the Board in 2003, it was neither considered nor endorsed. In July 2004, the Project Executive noted the draft Plan as a model for further development. However, the review of the Business Plan was put on hold pending the development and implementation of the new directions for the *Intelligent Island Program* announced in December 2005.

**4.70** In the absence of reporting program performance against agreed indicators, early six-monthly progress reports prepared for the program reported the performance of the initiatives against milestones outlined in the Implementation Plan. However, the ANAO noted that over time, reported milestone target dates changed, new milestones were added and others were replaced entirely, without any formal approval by the Board. These milestone changes have not been questioned or acted upon by DCITA. The ANAO considers that DCITA could have done more to ensure that all changes to milestones were formally approved by the Intelligent Island Board or the latter Project Executive.

**4.71** The ANAO considers that that DCITA is not in a strong position to determine the extent to which the *Intelligent Island Program* is achieving its objectives. DCITA's ability to monitor the performance of the program was inhibited by its lack of reporting against the performance measures and the lack of control over changes to milestones. In any event, significant delays to the program have resulted from a number of outstanding issues that will need to be resolved before the program could be considered to be on track to achieve its objectives.

**4.72** DCITA considers that the *Intelligent Island Program* has been monitored effectively in terms of its achievements against the specific initiatives. Some of its key performance indicators relate to general impacts on the ICT sector in Tasmania, which makes it difficult to distinguish between the impact from the program and the impact from other significant Australian Government funding. DCITA indicated that it will establish new arrangements to monitor the remainder of the program against key performance indicators. The program review scheduled for 2005–06 will now be conducted in 2006–07 after implementation of new program initiatives announced in December 2005.

## NCF Program

4.73 Of particular note during the implementation of the *NCF Program* were:

- the application of the specification review funding deed clause; and
- determining the quantum of project deliverables.

### *Specification reviews*

4.74 A clause inserted into the generic *NCF* funding deeds requires the Australian Government to conduct a 'specification review' of each project's request for tender document to engage a telecommunications carrier for the project. The specification review acts as a key element of the overall quality control process for the *NCF*. The review aims to ensure that network specifications in carrier tender documents are at the same level as included in the grantees' funding deeds and original applications.

4.75 However, the ANAO noted that a specification review was not conducted for the Outbacknet@qld project. DCITA indicated that it relied on the Queensland Government's SmartNet panel to ensure that the carrier tender met the general specifications and service levels required of all telecommunications infrastructure projects in Queensland. DCITA considered the SmartNet panel to be an adequate management control to compensate for the lack of a specification review. However the ANAO considers that decisions on waiving deed conditions should be taken by the appropriate delegate in DCITA and appropriately documented.

4.76 In respect of the Network WA project under the *NCF Program*, the WA Government sent a document outlining the carrier tender specifications to DCITA in the weeks preceding the funding deed's signing and the tender's release. DCITA decided not to forward the tender specifications to its consultant for review until the deed was signed. However, the WA Government released the tender on the same day the deed was signed, without feedback from DCITA on the tender specifications. DCITA's consultant completed the specification review within a couple of days of the tender's release and made no substantive recommendations for change.

4.77 Nevertheless, the benefit of the review and the strength of the Australian Government's position diminish if the review is not conducted before the tender is released. DCITA indicated that if a significant issue arose in the specification review, an amendment to the tender could have been made. The ANAO considers that this is not an ideal mitigating control. The

ANAO further considers that DCITA could have forwarded the specification document for review before the tender was finalised, noting its draft status, or delayed the tender until the review was conducted and specifications considered satisfactory.

### *Quantum of project deliverables*

**4.78** The ANAO noted that the number and cost of services proposed by at least one NCF project varied significantly between the original application and the final roll-out. This is not unexpected as improvements in ICT can occur in the period of time between the lodgement of an application and the calling for tenders. In this case, the grantee originally sought \$20 million NCF funding for its project to deliver telecommunications infrastructure to 58 health and education sites in 19 towns. However, once the telecommunications carrier was engaged, the grantee agreed to provide services to 308 sites in 62 towns for only \$8 million in NCF funding. DCITA indicated that the five-fold increase in site numbers that could be delivered was due to a new and unexpected service approach or offering from the telecommunications carrier. The ANAO considers that DCITA well managed the process to confirm the final number of sites where infrastructure would be installed.

### **Towns over 500 Program**

**4.79** The contract with Telstra for the *Towns over 500 Program* provided for on-site construction for the first town to begin in March 2002, with service to towns due to start June 2002 and for all towns to receive services by December 2003. However, there have been delays in Telstra's sites rollout, mainly due to difficulties in obtaining the necessary local government planning approval to build the sites. The ANAO notes that Telstra has attempted to mitigate the risk of program delays from this cause by entering into the site planning processes as early as possible. Delays have led to extensions to the contract and program to June 2005, and then to June 2006.

**4.80** As at May 2006, Telstra had rolled out services to 128 of the 131 towns.<sup>21</sup> The three remaining towns are at various stages of approval and construction, but services are expected to be provided to all three by July 2006. The ANAO considers that the *Towns over 500 Program* has effectively achieved its objectives.

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<sup>21</sup> By mutual agreement, one town was excised from the contract when Telstra could not obtain building approval.

Conclusion

4.81 The ANAO considers that DCITA monitored grantees’ performance against the funding deed, MOU or contract requirements according to sound practice for all programs subject to audit, except *BITS Incubator* and *Intelligent Island*. The ANAO questions the timeliness of, and justification for, varying one *BITS Incubator* funding deed that waived the injection of previously agreed payments from its consortium members. Although the performance monitoring regime for the *Intelligent Island Program* was well established, DCITA has not monitored the achievement of the program’s objectives using the agreed performance measures. This does not represent sound grant management practice.

4.82 The ANAO considers that all programs subject to audit, except the *Intelligent Island Program*, are effectively achieving their stated objectives. Significant delays to the *Intelligent Island Program* have resulted from a number of outstanding issues that will need to be resolved before the program could be considered to be on track to achieve its objectives. DCITA could have also taken earlier action to progress the *Intelligent Island Program*.

Acquitting funds

4.83 Grant acquittals are an integral part of good risk management and provide a measure of assurance that public funds allocated to grant recipients have been spent for their intended purposes. Reliable, timely and adequate evidence is required to demonstrate that grant funds have been expended in accordance with their terms and conditions.

4.84 The ANAO has assessed the performance of DCITA in acquitting funds for the programs subject to audit as:

BITS Incubator	ICT Incubators	BITS ANP	ANP2	BITS Intelligent Island	NCF	Towns over 500
✓✓	✓✓	✓✓	✓✓	✓	✓	✓✓

- ✓✓ complies with better practice principle in all material respects
- ✓ partially complies with better practice principle, but with some room for improvement
- × does not comply with better practice principle, with significant shortcomings
- na not applicable

4.85 The funding deeds, MOUs or contract for all programs subject to audit require grantees to:

- report quarterly or six-monthly on the period's income and expenditure of grant monies and other contributions, certified by the project's management; and
- report annually on each year's income and expenditure of grant and other contributions and have it independently audited (except for the *Towns over 500 Program* that requires an independent audit at the conclusion of the contract).

**4.86** The ANAO noted that DCITA usually ensured that they received and appropriately assessed the regular reports, annual audited financial reports and final reports (where applicable) for the projects. However, the ANAO found that:

- the first progress report for the *Intelligent Island Program* was received two years after the period to which it related;
- none of the *Intelligent Island Program* annual reports contained certification that the program's income and expenditure had been independently audited, and found to be correctly stated. (DCITA has since obtained the unqualified independent audit reports for the program from the Tasmanian Government and provided them to the ANAO); and
- no audited financial reports have been received for one *NCF* project since the project's start. The first material payments for the project were not made until late 2004–05. DCITA has waived the requirement to provide annual audited financial reports for the project until it is completed, which is expected in 2005–06.

**4.87** Audited financial reports are a key control mechanism to ensure Australian Government funding is spent on the projects. The ANAO considers that DCITA acquitted the funding for the *BITS Incubator*, *ICT Incubators*, *ANP*, *ANP2* and *Towns over 500* programs in compliance with better practice principles. Where significant amounts of funding have been disbursed, such as the case with the *Intelligent Island Program* and the *NCF* project referred to above, DCITA should require the grantees to provide audited financial reports in a timely manner.

# 5. Evaluating and Reporting Grant Program Performance

*This chapter assesses DCITA’s performance in evaluating grant programs and progressively reporting their progress and performance over the lives of the grant programs.*

## Managing the program reviews

**5.1** Periodic evaluations can contribute to improved grant program management, more informed decision-making, better use of resources and refined objectives, and greater accountability. Reviews and evaluations assess the continued relevance or appropriateness of the programs, the effectiveness of the programs, whether there are better ways to achieve program objectives, the need to establish new programs or extend existing programs and the adequacy of the resourcing of program management. Final project reports from grantees can also be a valuable mechanism to measure the extent to which projects have contributed to program objectives.

**5.2** The ANAO has assessed the performance of DCITA in managing reviews of the programs subject to audit as:

BITS Incubator	ICT Incubators	BITS ANP	ANP2	BITS Intelligent Island	NCF	Towns over 500
✓✓	✓✓	✓✓	✓✓	na	✓✓	na

- ✓✓ complies with better practice principle in all material respects
- ✓ partially complies with better practice principle, but with some room for improvement
- × does not comply with better practice principle, with significant shortcomings
- na not applicable

## Program mid-term reviews and final evaluations

**5.3** The *BITS Incubator*, *ANP* and *NCF* programs all underwent separate mid-term reviews and/or evaluations. The other programs subject to audit have not undergone a mid-term review or evaluation. The ANAO found that all mid-term reviews and evaluations were appropriately established and included in their terms of reference the requirement to analyse the performance of the projects and the programs against the programs’ respective objectives.

**5.4** The *BITS Incubator* evaluation (November 2003) was conducted by external consultants engaged by DCITA, whereas the *ANP* and *NCF* mid-term reviews (November 2003 and December 2004, respectively) were conducted by the DCITA staff managing the programs. The *NCF* final evaluation, due to report shortly, has been conducted by staff from DCITA's Communications Research Unit, who were not involved in the management of the programs.

**5.5** The ANAO noted that both the *BITS Incubator* evaluation and *ANP* mid-term review were significant inputs into the Government's decisions to extend both programs. The ANAO considers that reviews and evaluations undertaken by parties external to the responsible program area generally bring more objectivity to an assessment of the effectiveness and efficiency of particular programs. It is often the case that more significant reviews and evaluations in the public sector are undertaken with the involvement of parties external to the responsible program area. Whether external consultants are engaged commonly depends on the availability of the necessary skills within the department. Decisions to conduct reviews and evaluations are not intended to cut across the responsibilities of program managers to be responsive to the need to assess and modify programs to improve program performance.

**5.6** DCITA indicated that the original purpose of the *ANP* mid-term review was for DCITA to gain an in-depth knowledge of the projects' progress and any shortcomings or lessons that could be addressed or applied to the remainder of the program or to other programs. It later became an input to support an extension to the *ANP*.

## Final project reports

**5.7** All programs subject to audit, except *Intelligent Island* and *Towns over 500*, require grantees to prepare and submit stand-alone final reports of their projects that outline qualitative and quantitative performance and impacts. This requirement was deferred for those *BITS Incubator* and *ANP* projects that received additional funding under *ICT Incubators* and *ANP2* programs, respectively.

**5.8** The ANAO considers that exempting the requirement for final reports from the *Intelligent Island* and *Towns over 500* programs was appropriate given the circumstances. The *Intelligent Island Program*, containing seven initiatives and projects within each initiative, would have made final reporting at the same level as other programs subject to audit, unworkable. Performance under Telstra's contract to deliver the *Towns over 500 Program* relates to the rollout of

specific and well-defined services, which can be measured quantitatively and reported progressively. Telstra is not required to assess or report the impact the services have on the communities they are provided to.

Conclusion

5.9 The ANAO considers that DCITA established the requirements for mid-term reviews and evaluations of the *BITS Incubator*, *NCF* and *ANP* programs, and final reports from grantees for all relevant programs subject to audit, in accordance with sound practices. Exempting the *Intelligent Island* and *Towns over 500* programs from providing final reports was appropriate in the circumstances.

Carrying out the program reviews

5.10 Mid-point reviews and evaluations should, fundamentally, report on the extent to which grant programs are achieving or have achieved their objectives. A significant element of reviews and evaluations is examining the achievements, benefits and value-added from the government-funded grant projects. Reviews and evaluations can also make recommendations for actions impacting on the program or impacting on the design of, or the need for, extended or new programs.

5.11 The ANAO has assessed the performance of DCITA in carrying out the reviews of the programs subject to audit as:

BITS Incubator	ICT Incubators	BITS ANP	ANP2	BITS Intelligent Island	NCF	Towns over 500
✓	✓✓	✓✓	✓✓	na	✓✓	na

- ✓✓ complies with better practice principle in all material respects
- ✓ partially complies with better practice principle, but with some room for improvement
- ✗ does not comply with better practice principle, with significant shortcomings
- na not applicable

Program mid-term reviews and final evaluations

5.12 The mid-term reviews or final evaluations of the *BITS Incubator*, *ANP* and *NCF* programs, overall, reported positively of the projects' and programs' achievements against their programs' respective objectives. The reviews and evaluations also highlighted the challenges faced by the projects and programs and performance shortcomings. The ANAO considers that the reviews and evaluations provide a reasonable encapsulation of the performance of the

respective programs and funded projects. Only the *BITS Incubator Program* was not able to measure the performance of the program against all of its objectives. The evaluators were unable to use indicators of incubator or incubatee sustainability due to the timing of the evaluation in the life-cycle of the program. Incubator sustainability is highly dependent on further funding (a matter to be considered by Government) and/or a successful exit, which is very difficult to assess. Incubatee sustainability is usually measured by the survival rate three years after graduation—a point not reached by any incubatee at the time of the evaluation.

**5.13** Table 5.1 below summarises the reported performance of each program.

### **Final project reports**

**5.14** DCITA has not yet received final reports from the two BITS incubators that received no further government funding, and is unlikely to receive them. One incubator is now a passive holding company and the other is in liquidation. As all the *BITS Incubator* funding has been spent by these two incubators, there is no practical incentive or sanction available to DCITA to enforce compliance with the funding deeds in respect of the production of final reports. The ANAO considers that DCITA may be facing the same risk in respect of those ICT incubators that will not be self-sustaining at the end of the *ICT Incubators Program* funding period. The ANAO further considers that where the financial viability of the grantee is at risk, DCITA could attach a small, but financially attractive, grant payment to the grantee's submission of a satisfactory final report.

**5.15** DCITA notes that withholding project funds to obtain final project reports must be balanced against potential adverse impacts for the projects and the program. Due to the nature of incubators they need cash reserves up-front for seed capital investments and ongoing operating expenses. Withholding grant money until after the activity period was concluded could have a detrimental impact on program outcomes. DCITA also noted that if incubators do not meet their grant deed obligations, other Australian Government funding can be withheld.

**Table 5.1**

**Summarised performance of the BITS Incubator, ANP and NCF programs reported in mid-term reviews or evaluations**

<b>BITS Incubator</b>
<p>In respect of the BITS Incubator Program objectives, the evaluation noted that the program:</p> <ul style="list-style-type: none"><li>• has improved the rate of commercialisation of ICT ideas, research and development;</li><li>• has assisted eligible incubatee firms to reach their full potential;</li><li>• has played a significant role in the national innovation system by filling a gap between the seeds of a new ICT idea and the level at which venture capital sources will invest; and</li><li>• has ensured that many incubators are well placed to be viable and substantially self-sustaining over the next few years, although none of the incubators are currently viable without going funding support from the Programs.</li></ul> <p>The evaluation concluded that ‘the BITS and Intelligent Island Incubator Programs have performed well in the circumstances’ and that ‘while some Incubators have been more successful than others, in general, Incubator performance has been strong’. Nevertheless, without further funding assistance, most of the Incubators will not be viable and a number of promising incubatees currently receiving assistance will fail. ‘This would result in a write-off of most of the Australian Government’s investment in the BITS and Intelligent Island Incubator Programs.’</p>
<b>ANP</b>
<p>The ANP mid-term review concluded that:</p> <p>‘the Advanced Networks Program is on track to meet its objective as indicated by the assessment of this review that:</p> <ul style="list-style-type: none"><li>• overall the three projects have met or exceeded all obligations against milestones in their funding deeds to date; and</li><li>• the projects are performing well against all key performance indicators for the program ...’.</li></ul> <p>The mid-term review noted the program’s (positive) achievements against its key performance indicators.</p> <p>However the review also noted that:</p> <ul style="list-style-type: none"><li>• ‘without a further period of funding support, the ANP projects cannot maintain the projects in their current form beyond mid-2004 and their research and development activities will be severely curtailed; and</li><li>• the benefits from the significant investment (about \$130 million) by the recipients, the ICT industry and Australian Government will not be fully realised.’</li></ul> <p>Consequently, the ANP mid-term review recommended that the ‘... projects should be extended to allow them to cover operational costs and to continue their network R&amp;D and development of applications, business systems and services’.</p>

## NCF

At the time of the mid-term review, not all of the projects had commenced delivering services so it was not possible to assess the full extent of the success of the program, or the degree to which the program is improving telecommunications services generally in regional communities.

Nevertheless, for those projects where new services have commenced 'feedback from project managers and technicians implementing the projects, education and health practitioners using the new services, and end users of the services are overwhelmingly positive'. The mid-term review also considered that 'benefits from the projects are already being gained in many areas ...' and 'more benefits ... are expected as the remainder of the projects are fully implemented'.

The mid-term review also found that:

- several of the projects have used NCF funding as a catalyst for bigger projects or are integrating the NCF component into a state-wide communications strategy;
- most of the NCF projects have completed or are nearing completion of the rollout of infrastructure. Completion by the end of June 2005 is in doubt for one project, Outbacknet@qld;
- sustainability is being built into all of the projects, with the ongoing operating costs being met from state government's recurrent funding of their education and health agencies for the majority of projects;
- the NCF program is being administered efficiently according to the criteria set out by the Department of Finance and Administration for reviews of this type; and
- the NCF program is on track to meet its key performance indicators.

Source: Adapted from *Evaluation of the BITS Incubator Program & Intelligent Island Incubator: Final Report* (November 2003), *Advanced Networks Program Mid-Term Review* (November 2003) and *National Communications Fund Mid-Term Review* (December 2004).

**5.16** The ANAO considers that the information in the NCF final report it examined will assist to measure the project's and program's performance against its objectives and key performance indicators.

**5.17** Final project reports under the *ICT Incubators* (including continuing *BITS Incubator*), and *ANP2* (including all *ANP* projects) programs are not yet due.

## Conclusion

**5.18** The ANAO considers that the mid-term reviews and final evaluations complied with better practice principles as they measured the performance of the grantees and the programs against the programs' respective objectives. The ANAO also considers that the reviews and evaluations provide a reasonable encapsulation of the performance of the respective programs and funded projects at the time the reviews and evaluations were conducted. Final project reports, when received, have helped measure the programs' performance against their objectives and key performance indicators. However, the ANAO notes that there is a risk that DCITA will not receive final project reports from the two BITS incubators that received no further government funding.

## Reporting the programs' performance

**5.19** Public reporting of performance against outputs, outcomes and program objectives is the primary means through which agencies and the Government discharge their accountability requirements to Parliament and the public. In the absence of any separate, tailored performance reports, this accountability is usually achieved through disclosure in departmental annual reports.

**5.20** The ANAO has assessed the performance of DCITA in publicly reporting on the programs subject to audit as:

BITS Incubator	ICT Incubators	BITS ANP	ANP2	BITS Intelligent Island	NCF	Towns over 500
✓	✓	✓	✓	✓	✓	✓✓

✓✓	complies with better practice principle in all material respects
✓	partially complies with better practice principle, but with some room for improvement
×	does not comply with better practice principle, with significant shortcomings
na	not applicable

## Program mid-term reviews or final evaluations

**5.21** The mid-point review or evaluation of the *BITS Incubator* and *ANP* programs were valuable inputs into the justification for extensions to these programs to consolidate their emerging benefits (applicable to the *BITS Incubator* and *ANP* programs) and to assist with the self-sustainability of the assisted incubators (*BITS Incubator Program*). After announcing the extension of the *ANP* and the successful incubators under the *ICT Incubators Program*, the government released respectively the mid-point review and the evaluation to the public. Cabinet-in-confidence and commercial-in-confidence material was removed from the mid-point reviews and evaluations before their public release.

**5.22** The *NCF* mid-term review was released to the public in June 2005 after receiving approval from the Minister. DCITA indicated that the six-month delay between the review's completion and release date reflected clearance mechanisms.

## Annual reporting

**5.23** Since 2000–01, DCITA has published separate annual reports for its BITS Incubator Program. Given the innovative nature of, and the stakeholder

interest in, the program, the ANAO considers that its separate annual reporting is a good and valuable initiative. However, the ANAO found that they are published over a year after the end of the reporting period to which they relate. This reduces their usefulness as a management and reporting tool. DCITA indicated that the incubators contributed to the delays by the late submission of their audited reports. DCITA intends to continue to separately report annually on the performance of the incubators under ICT Incubators Program. Regular reporting of all other programs subject to audit occurs through DCITA's annual reports.

**5.24** Although the BITS Incubator Program annual reports did not report against program objectives, the ANAO considers that they provided a reasonable encapsulation of incubator performance. The ANAO considers that annual reporting under the later ICT Incubators Program would be enhanced if DCITA also directly assessed its performance against the program's objectives.

**5.25** The ANAO considers that the reporting for the ANP, ANP2 and NCF programs in DCITA's annual reports provides some measurement of the programs' performance against their objectives. However, additional performance measures, as recommended in the ANP mid-term review, would provide more meaningful insights into the ANP and ANP2 projects' and programs' performance. DCITA considers that these additional indicators reflected the progress of the program and issues that had emerged since the start of the program. It is DCITA's intention to report against these indicators in future evaluations.

**5.26** The ANAO found that NCF annual reporting provides only brief coverage of two of the five key performance indicators (KPIs) for the program. Program performance against the KPIs relating to projects achieving their outcomes, project sustainability and the involvement of other organisations have not been covered. At this late stage of the program, DCITA should be in a position to report against these KPIs, particularly given that the NCF final evaluation is also due to report in 2005–06. As a general rule, DCITA would be expected to report against every program objective at some point over the programs' lives. DCITA indicated that there was not sufficient space in DCITA's annual reports to cover all KPIs for all programs, but that the significant KPIs for the NCF have been reported.

**5.27** The ANAO found that the annual reporting of the Towns over 500 Program, given the specific nature of its delivery requirements, provides a

reasonable encapsulation of the performance of the program against its objectives.

**5.28** The ANAO also found that the performance of the *Intelligent Island Program* has not been reported against its objectives. However, the significant delays to the implementation of the program have inhibited DCITA's ability to do so. Nevertheless, measuring the program's performance against the performance indicators in the current *Intelligent Island Business Plan* would assist the program's annual reporting in the future.

## **Conclusion**

**5.29** The ANAO considers that annual reporting for most programs subject to audit would be enhanced if DCITA placed greater emphasis on measuring and reporting publicly the programs' performance against their objectives. Reporting of the performance of the *Towns over 500 Program* complied with better practice principles.

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Ian McPhee  
Auditor-General

Canberra ACT  
29 June 2006

# Appendix



## Appendix 1: Performance measures for the programs subject to audit

### **BITS Incubator Program**

Performance measures include:

- the number of applications from start-ups received by the incubators;
- the number of start-ups accepted into incubation;
- the number of incubatees who graduated from incubation;
- the amount of non-government, non-incubator funds leveraged for the incubatees or incubators;
- details of incubatee exits; and
- employment resulting from incubatee investments (new for 2003–04).

### **ICT Incubators Program**

Performance measures include:

- leverage of program funds;
- number of incubatees;
- number of incubatee graduates;
- valuation of equity held in investment portfolio;
- the extent to which incubators have achieved self-sustaining operations;
- integration with other elements of Australia's innovation infrastructure;
- support for incubatees;
- incubatee achievements (including increasing employment, revenue and exports since entering incubation);
- incubatee or graduate sustainability; and
- satisfaction of incubatees

## **ANP and ANP2**

Performance measures include:

- the use of the facilities (using measures such as the quantity of data carried over the networks and the number of application development companies supported);
- descriptors of the positive impact the networks are having on the work of researchers;
- the leveraging of non-Commonwealth external funding (the amount of cash and in-kind contributions from grantee consortium members); and
- descriptors of the contributions the *ANP* is making to the national backbone network for research and education.

## **NCF**

Performance measures include:

- improved access to telecommunications (including the number of education institutions, health facilities and School of the Air students impacted); and
- improvements in telecommunication infrastructure (including the number of regional towns that have new or improved broadband infrastructure).

## **Towns over 500**

Performance measures include:

- the start date for rolling out services and finish date for complete rollout;
- the pace of rollout; and
- defined services provided in designated towns within designated areas to the Bell 90/90 performance standard, excluding defined 'black spots'.

## Intelligent Island

Performance measures for each initiative included:<sup>22</sup>

- |  |  |
|--|--|
| 1. Incubator                                 | <ul style="list-style-type: none"> <li>• the amount of external capital attracted</li> <li>• the number of graduating firms</li> <li>• the quality of incubator services as measured by the satisfaction of participating firms and partner organisations</li> </ul>   |
| 2. Enterprise Development Fund <sup>23</sup> | <ul style="list-style-type: none"> <li>• the amount of external capital available for leveraging up the Intelligent Island funded component</li> <li>• the number and nature of Tasmanian information technology and telecommunications (IT&amp;T) firms assisted through the initiative</li> <li>• anticipated growth in the IT&amp;T industry in Tasmania as a result of the initiative</li> </ul>                   |
| 3. Centre of Excellence                      | <ul style="list-style-type: none"> <li>• the number and quality of research projects</li> <li>• the value of commercialisable intellectual property generated</li> <li>• the level of participation by industry</li> <li>• linkages established to related centres in Australia and worldwide</li> </ul>   |
| 4. Support for education and training        | <ul style="list-style-type: none"> <li>• an increase in the number of IT practitioners working in Tasmania</li> <li>• increased interaction and involvement between all levels of education/training and industry</li> <li>• increased numbers of IT graduates and teachers at all levels of education/training</li> <li>• a decline in the proportion of IT graduates leaving the state to find employment</li> </ul> |

<sup>22</sup> The original performance measures for the program are produced here. New measures were endorsed in July 2004.

<sup>23</sup> In 2002–03, this element was replaced by an Industry Development grant program.

- |  |  |
|--|--|
| 5. Investment attraction                   | <ul style="list-style-type: none"> <li>• attracting a suitable number of partners with a national or global presence</li> <li>• improvements in the local skills base as a result of collaboration with strategic partners</li> <li>• improvements in the opportunities available to local IT&amp;T firms as a result of collaboration with strategic partners</li> <li>• improvements in the access to external markets as a result of collaborations with strategic partners</li> <li>• the number of quality of R&amp;D projects conducted with strategic partners</li> </ul> |
| 6. Telecommunications infrastructure study | <ul style="list-style-type: none"> <li>• the quality of investigation into creative and practical options for alignment of the telecommunications infrastructure with Tasmania's industry development goals</li> </ul>   |
| 7. Marketing                               | <ul style="list-style-type: none"> <li>• the level of community involvement—including the extent to which there is an understanding of the Program's objectives, strategies and initiatives</li> <li>• an improvement in community understanding within Tasmania of the importance of other Intelligent Island initiatives</li> <li>• the extent to which Tasmania is considered a place for investment and a source of world-class products and services</li> </ul>   |

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