

The Auditor-General  
Audit Report No.22 2007–08  
Performance Audit

# **Administration of Grants to the Australian Rail Track Corporation**

**Department of Infrastructure, Transport, Regional  
Development and Local Government**

Australian National Audit Office

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of Australia 2008

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Canberra ACT  
14 February 2008

Dear Mr President  
Dear Mr Speaker

The Australian National Audit Office has undertaken a performance audit in the Department of Infrastructure, Transport, Regional Development and Local Government in accordance with the authority contained in the *Auditor-General Act 1997*. I present the report of this audit and the accompanying brochure to the Parliament. The report is titled *Administration of Grants to the Australian Rail Track Corporation*.

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

Yours sincerely

A handwritten signature in black ink, appearing to read 'Ian McPhee', is positioned above the printed name.

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

The Auditor-General is head of the Australian National Audit Office. The ANAO assists the Auditor-General to carry out his duties under the *Auditor-General Act 1997* to undertake performance audits and financial statement audits of Commonwealth public sector bodies and to provide independent reports and advice for the Parliament, the Government and the community. The aim is to improve Commonwealth public sector administration and accountability.

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## Abbreviations/Glossary

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AFM	Advance to the Finance Minister
AGS	Australian Government Solicitor
ALTD Act	<i>Australian Land Transport Development Act 1988</i>
ALTD Notes on Administration	<i>Australian Land Transport Development (ALTD) Act 1988 National Highway and Roads of National Importance Notes on Administration</i>
ARTC	Australian Rail Track Corporation
AusLink Act	<i>AusLink (National Land Transport) Act 2005</i>
AusLink Investment Program	Includes the funding programs established under Section 3, 4 and 5 of the AusLink Act and funding for old ALTD Act projects that are located off the National Network
AusLink National Project	Includes projects approved under subsection 9(1) of the AusLink Act and projects approved under subsection 26(3) of the ALTD Act that were transitioned to the AusLink Act by Ministerial Determination.
AusLink Notes	<i>AusLink Investment Program: National Projects Notes on Administration</i>
CEO	Chief Executive Officer
CRF	Consolidated Revenue Fund
DITRDLG	Department of Infrastructure, Transport, Regional Development and Local Government
DOTARS	The former Department of Transport and Regional Services, now the Department of Infrastructure, Transport, Regional Development and Local Government

Finance	The former Department of Finance and Administration, now the Department of Finance and Deregulation
FMA Act	<i>Financial Management and Accountability Act 1997</i>
FMA Regulations	<i>Financial Management and Accountability Regulations 1997</i>
GBE	Government Business Enterprise
JCPA	The former Joint Committee of Public Accounts (now the Joint Committee of Public Accounts and Audit)
MoU	Memorandum of Understanding
National Network	The defined network of road, rail and intermodal links determined by the Minister for Transport and Regional Services under Part 2 of the AusLink Act.
NSW Lease	A 60-year lease of the NSW interstate freight and Hunter Valley rail lines entered into between the ARTC and the NSW State Government on 4 June 2004.
OPC	Office of Parliamentary Counsel
PM&C	Department of the Prime Minister and Cabinet
Special grants	Three separate 'one-off' grants paid to the ARTC at the end of each financial year from 2003–04 to 2005–06.
Transitional Act	<i>AusLink (National Land Transport – Consequential and Transitional Provisions) Act 2005</i>
Treasury	Department of the Treasury



# **Summary and Recommendations**



# Summary

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## Introduction

1. Australian Government spending on land transport is guided by the June 2004 AusLink White Paper *'Building Our National Transport Future'*. Under AusLink, a defined National Network of road and rail infrastructure links and their intermodal connections has been established with \$10.533 billion in funding allocated to the National Network under AusLink over the period 2004–05 to 2008–09. Under the Administrative Arrangements Order of 25 January 2008, the Department of Infrastructure, Transport, Regional Development and Local Government (DITRD LG) is responsible for administering the various AusLink funding programs. The administration of its predecessor department, the Department of Transport and Regional Services (DOTARS), is the central focus of this audit.
2. The Australian Rail Track Corporation (ARTC) commenced operations in 1998. Its primary role is to provide access to that part of the interstate rail network managed by the company. The ARTC is a company incorporated under the *Corporations Act 2001* and is a Government Business Enterprise (GBE) wholly-owned by the Australian Government. At the time of audit, the then Minister for Transport and Regional Services and the then Special Minister of State represented the Australian Government as shareholders of the company. DOTARS and the then Department of Finance and Administration (Finance)<sup>1</sup> were the departments responsible for administering the reporting and accountability arrangements that facilitate active oversight of the ARTC as a GBE.<sup>2</sup>
3. The ARTC receives funding for its operations from a variety of sources. The ARTC's primary source of revenue from continuing operations has been access revenue received by way of fees charged to rail operators for access to the tracks maintained by the ARTC. The ARTC also receives revenue from non-operating activities, which includes interest income and government grants.

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<sup>1</sup> Under the Administrative Arrangements Order of 25 January 2008, the Department of Finance and Deregulation is responsible for shareholder advice on GBEs. This audit examines the administration of its predecessor department, the Department of Finance and Administration. The Department is referred to as Finance throughout this report.

<sup>2</sup> *Governance Arrangements for Commonwealth Government Business Enterprises*, June 1997, p. 3.

4. As at September 2007, \$975.3 million in Australian Government grant funding had been approved for the ARTC as part of the Australian Government's \$10.533 billion commitment under AusLink. This has comprised:

- \$155.3 million to be paid as work progresses, for eight specific projects that are subject to the provisions of the relevant land transport legislation (the *AusLink (National Land Transport) Act 2005* (AusLink Act) since July 2005) and to various conditions set out in other related documentation. As at September 2007, \$70.7 million (46 per cent) of the approved funding had been paid to the ARTC; and
- \$820 million in three direct lump-sum grants that are not subject to the provisions of the land transport legislation. These grants were paid to the ARTC on 29 June 2004 (\$450 million), 30 June 2005 (\$100 million) and 27 June 2006 (\$270 million). As of 30 June 2007, ARTC had reported to DOTARS and Finance that \$237.1 million (29 per cent) of the special grant funds had been used.

## Audit objectives and scope

5. The objective of this performance audit was to assess the effectiveness of the administration of grants made to the ARTC. The audit involved an examination of DOTARS' administration of the grant funding approved for, and paid to, the ARTC (in respect of both the grants paid for projects approved under legislation and the three special grants). It also involved consideration of the role of Finance and the Department of the Prime Minister and Cabinet (PM&C) in advising on the special grant funding and (in respect of Finance) the payment and reporting arrangements for the grants. The audit was conducted under Section 18 of the *Auditor-General Act 1997*.

## Audit conclusions

6. The \$975.3 million of ARTC grant funding represents some nine per cent of the Australian Government's \$10.533 billion investment in the AusLink National Network over the period 2004–05 to 2008–09. The ARTC grant funding has been provided to assist in improving the performance of the interstate rail network, including by reducing transit times so as to make rail more competitive with road freight.

7. To provide confidence that grants will achieve their intended outcomes, it is important that there be a clear understanding of the purposes for which the funds are to be used, together with effective and ongoing monitoring of

project progress and acquittal of the use of the grant funds. In some cases legislation imposes terms and conditions on grant funding. However, in many cases the purposes and necessary conditions of grant funding is governed by a document signed by both the administering department and the recipient (often called a funding agreement). Where discretionary grant funding is being provided to a GBE, there are also issues in aligning the commercial incentives of the GBE with the particular outcomes sought through the provision of discretionary grant funding.

8. Project-specific governance arrangements exist for administering the eight grants to the ARTC totalling \$155.3 million that were approved under the applicable land transport legislation. Collectively, the legislation, associated Notes on Administration and a Memorandum of Understanding between DOTARS and the ARTC, signed in January 2007, set out details of the payment arrangements for each project, and processes for the reporting of project progress and the acquittal of the grant monies provided. These arrangements, and their administration, have been effective.

9. The majority (84 per cent) of the grant funding to the ARTC is being provided through the three special grants that total \$820 million. The first special grant (of \$450 million) was awarded in May 2004, as a result of advice to Ministers that DOTARS, in consultation with the ARTC, considered that the highest remaining priority for rail investment was the North NSW Coast line. That advice was based on limited consultation by DOTARS with ARTC in relation to the possible quantum of funds, the projects likely to be undertaken by the ARTC and the timeframe over which the funding would be spent by the company. As a result:

- following the payment of the grant, the ARTC reviewed its infrastructure works program to take account of the significant increase in available funding. This review, completed the following year, led to the ARTC changing the use of the first (\$450 million) grant from rail realignments on the North NSW Coast line (the purpose approved by Ministers) to passing lanes between Melbourne and Junee as well as loop extensions and other works (but no rail realignments) on the North NSW Coast line; and
- each of the three special grants was paid to the ARTC significantly in advance of any construction work commencing.

10. In settling the administrative arrangements for the provision of the special grant funding, DOTARS and Finance gave considerable weight to the ARTC's desired taxation position. Specifically, to assist in positioning the

company to not pay income tax on the special grants, the projects being funded have been selected solely by the company and there are no funding agreements (or similar) in place to govern the use of the funds. This means that the grants have been paid on an untied basis rather than in a way that ensures the funds are used for the purposes approved by Ministers at the time they made their decision to award funding.

11. To obtain information on the projects being funded and their progress, DOTARS advised ANAO that it is relying on the broader governance framework that applies to the ARTC as a wholly-owned Commonwealth GBE. As part of the quarterly meetings with DOTARS and Finance in their role as shareholder departments, the ARTC has recently commenced providing progress reports on the projects funded by the special grants. Nevertheless, the GBE governance framework is focused on the strategic direction and oversight of entities designated as a GBE and is not a substitute for the benefits that funding agreements provide. For this reason, the normal approach adopted when grants are provided to GBEs is to tailor a funding agreement to the specific requirements of the particular grant.<sup>3</sup>

12. This audit highlights the importance of departmental advice to Ministers being well informed, or suitably qualified where not all initial information is firm. It further highlights the importance of departments having suitable arrangements in place to ensure that grant funding is applied for the purposes approved by Ministers. In situations where circumstances or new information suggests the approved funding purposes would benefit from review, further advice should be provided to the decision-makers to provide the opportunity for the original decision to be reconsidered or confirmed.

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<sup>3</sup> See, for example, ANAO Audit Report No.14 2007–08, *The Regional Partnerships Programme*, Canberra, 15 November 2007, Volume 2—Main Report, p. 175 which outlined that a Memorandum of Understanding was signed in June 2004 with Telstra Corporation Ltd to govern a \$2.5 million grant for the supply of a replacement mobile phone service to Christmas Island. The MOU included details of the purpose for which funding was being provided, progress reporting requirements and financial acquittal requirements.

## Key findings

### Grants governed by land transport legislation (Chapter 2)

13. The AusLink land transport policy was given effect by the *AusLink (National Land Transport) Act 2005* (AusLink Act), enacted on 6 July 2005.<sup>4</sup> The legislation is supported by:

- Notes on Administration issued by DOTARS as a working draft in October 2005 and in final form in March 2006. The Notes on Administration set out processes for funding recipients under the AusLink Act to implement the requirements of the Act, including approval and funding frameworks, and reporting requirements for funding recipients; and
- a January 2007 Memorandum of Understanding (MoU) between DOTARS and the ARTC in respect of the projects approved for the ARTC under the AusLink Act.<sup>5</sup> The MoU addresses a number of issues relating to the ARTC's AusLink National Projects including:
  - funding purposes and contributions, which includes the types of costs eligible to be funded by the Australian Government;
  - variations to projects and funding, including the manner in which variations to the cost of a project may be dealt with;
  - terms and conditions of Australian Government funding for approved projects; and
  - potential consequences of non-adherence to the terms of the memorandum.

14. Collectively, this documentation provides a sound governance regime for grant funding approved under the applicable land transport legislation for payment to the ARTC. Specifically, through the legislation, Notes on Administration and MoU, there exists:

- a defined scope and approved funding amount for each project;

<sup>4</sup> Prior to this time, the applicable land transport legislation was the *Australian Land Transport Development Act 1988* (ALTD Act).

<sup>5</sup> This includes projects that were originally approved under the ALTD Act, and which were transitioned to the AusLink Act upon its commencement in July 2005.

- documented terms and conditions applying to the provision of funding, and the process by which payments will be calculated and made;
- requirements for monthly progress reports, variations to approved projects and reporting on project completion; and
- accountability arrangements including audited financial acquittals.

15. ANAO found that, with no significant exceptions, the \$155.3 million in funding approved for eight projects under the AusLink Act<sup>6</sup> has been paid and administered in accordance with the documented governance framework.

### Special grants (Chapter 3)

16. In each year from 2003–04 to 2005–06, special grants were approved for the ARTC to spend on rail infrastructure improvements. Each of the three grants was provided to the ARTC in the context of assisting to reduce higher than expected budget surpluses,<sup>7</sup> with the payment of each grant being made before 30 June in the relevant financial year. The payments were approved as grants to the ARTC, as the alternative considered (an equity injection) would not have had the desired effect of reducing expected budget surpluses.<sup>8</sup> These three special grants totalled \$820 million, as follows:

- \$450 million was approved in May 2004 and paid in June 2004 for rail re-alignments on the North NSW Coast line. These funds are, in fact, being largely applied to other works identified in the ARTC's May 2005 North-South Corridor Strategy, with a specific focus on sections of rail line between Melbourne and Junee;

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<sup>6</sup> One of the eight projects was approved after the AusLink Act commenced. The other seven projects were approved under the prior legislation and transitioned to AusLink.

<sup>7</sup> For example, in relation to the first (\$450 million) special grant, in the context of the 2004–05 Budget, DOTARS, Finance and the Department of the Treasury (Treasury) were asked to contribute advice to the Department of the Prime Minister and Cabinet (PM&C) concerning the scope and practicality of making payments in 2003–04 across a range of areas of government activity, most of which had been the subject of earlier advice to Ministers. The grant, made in 2003–04, was announced as a Budget Measure in the 2004–05 Budget Papers.

<sup>8</sup> The provision of grant funding to GBEs is relatively uncommon. ANAO's examination of records held by Finance showed that, in the context of examining options for measures to reduce the 2003–04 budget surplus, Finance considered that the proposed option of providing a grant of \$450 million to the ARTC 'presented the Australian Government as sole ARTC shareholder with a challenge to reconsider how it will marry the use of the grants with the commercial incentive model of a commercially financed GBE, the ultimate objective being to promote efficient resource allocation'. However, Finance also considered that this did not provide a reason to forego the grant funding.



- \$100 million was approved and paid in June 2005 to also be spent as part of the North-South Corridor Strategy (in this instance, mainly concrete re-sleepering and passing lanes). The majority of these funds are being used in a manner that is consistent with the works approved by Ministers; and
- \$270 million was approved in April 2006 and paid in June 2006 for targeted concrete re-sleepering on the Melbourne-Sydney-Junee sections and the Newcastle to Queensland border sections of the North-South rail corridor. The use of these funds is consistent with the works approved by Ministers.

17. There had been limited consultation with the ARTC on the possibility of a substantial injection of funding for rail infrastructure spending prior to the approval of the first (\$450 million) special grant. Specifically, prior to the grant being approved, the ARTC was not asked to provide any formal advice on specific areas in which a grant of that quantum could be applied, or the timeframes over which funds could be expended. This was reflected in:

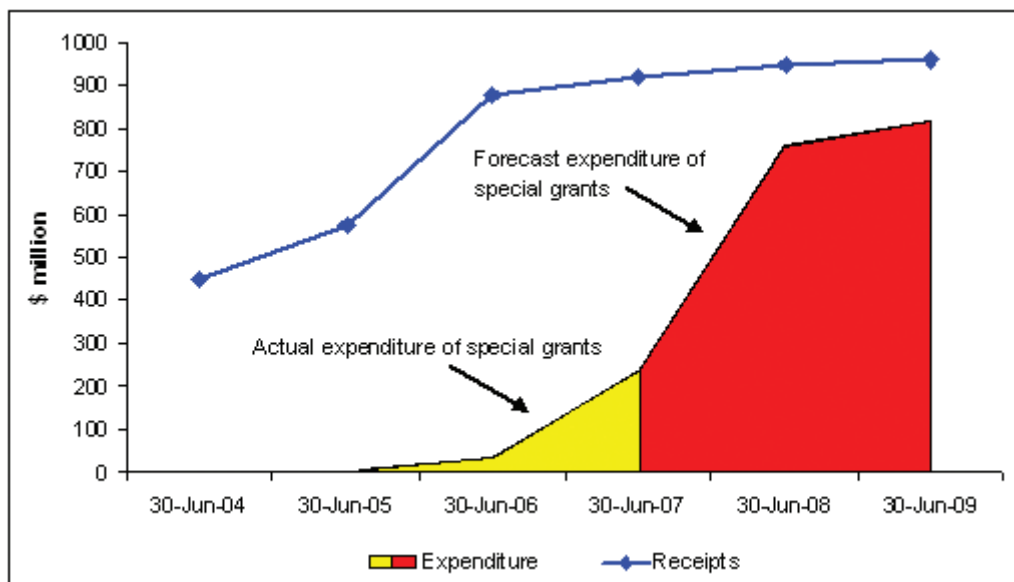
- the ARTC re-evaluating the overall program of works that had been contemplated prior to the payment of the grant. In turn, this led to an extended period between funds being paid to the ARTC and the funds being spent by the company (see Figure 1). In the interim, the ARTC invested the funds (in accordance with a revised company treasury policy) with the large increase in company investment holdings resulting in a significant increase in the ARTC's interest earnings;<sup>9</sup> and
- significant changes being made to the use of the first special grant between the indicative program of works that was submitted by the ARTC in May 2004 (that focused on North NSW Coast line re-alignments) and the program that was finalised in May 2005 (mainly passing lanes between Melbourne and Junee and loop extensions and other works on the North NSW Coast line).<sup>10</sup>

<sup>9</sup> ANAO estimated that, by 30 June 2009, when the ARTC has advised DOTARS it expects to have spent the full \$820 million, the advance payments will have cost the Australian Government some \$141 million in foregone interest earnings. In October 2007, DOTARS advised ANAO that interest earned on ARTC investments is being applied to extending the works program to which the company is applying the special grants.

<sup>10</sup> In its May 2005 advice to the shareholder departments regarding the finalised program of works for the first special grant, the ARTC indicated that a program of passing lanes was to be undertaken in place of the initially proposed track deviations (re-alignments) as there were a number of strategic advantages with passing lanes including shorter construction times and substantially lower cost risks.

**Figure 1**

## Receipt and expenditure of special grants



Source: ANAO analysis of DOTARS records.

Note to Figure: Receipts includes estimated interest earnings from investment of the special grants.

## Governance arrangements

18. The funds were paid to the ARTC as grants rather than as equity injections so as to reduce the budget surplus—the option of making the payments as equity injections would not have had the desired accounting effect. In the absence of legislation mandating the conduct and conditions applied to grant programs and individual grants, a funding agreement is often used. However, there are no contracts, funding agreements or documented governance arrangements that require the ARTC to use the \$820 million in special grant funding on any particular projects or in any particular timeframe.

19. The absence of funding agreements is a direct consequence of steps taken by DOTARS and Finance to allow the ARTC to treat the first special grant as non-assessable for income taxation purposes.<sup>11</sup> Specifically, the May 2004 letter from the then shareholder Ministers to the ARTC advising of the grant was drafted by their departments so as not to specify that the

<sup>11</sup> Treasury was not consulted by DOTARS on the merits of assisting the ARTC to treat the grants as not taxable. This was notwithstanding that, in July 2004, in the context of preparing the draft AusLink legislation, Treasury had advised DOTARS that allowing grant payments to the ARTC and taxable non-government entities to be tax exempt would lead to policy and taxation administration difficulties.

\$450 million was to be spent on rail re-alignments on the North NSW Coast line (the works that the then Prime Minister had specified in his approval of the grant). Rather, the correspondence stated that the funding was being provided for use in accordance with the objectives for which the company was established and asked the ARTC to inform the shareholder Ministers of the highest priority investments that could be undertaken with the additional funding being provided.<sup>12</sup>

**20.** Later in May 2004, an indicative list of projects was provided by the ARTC to the shareholder Ministers and, subsequently, by the then Minister for Transport and Regional Services to the then Prime Minister. However, DOTARS did not advise its then Minister that the indicative program had yet to undergo detailed analysis and modelling, or indicate that not all of the projects identified were rail re-alignments. Accordingly, this information was also not conveyed to the then Prime Minister. In September 2004, PM&C raised concerns with DOTARS that the projects to be undertaken by the ARTC with the first special grant were not wholly consistent with those that had been put to the then Prime Minister when he approved the grant.

**21.** On 27 May 2005, 12 months after the ARTC produced its indicative program of works, the company provided DOTARS and Finance with an updated program of works referred to as the North-South Corridor Strategy. The ARTC advised the shareholder departments that, having now undertaken the detailed analysis of the proposed program of works, it had concluded that the strategy that would best achieve the maximum market share change and minimise risk was in fact a significant program of passing lanes to be constructed between Melbourne and Junee, and not the initially proposed works on the NSW North Coast.

**22.** The special grants awarded in June 2005 (\$100 million) and April 2006 (\$270 million) were given effect by the shareholder departments in a manner similar to the first (\$450 million) special grant.<sup>13</sup> As a result, for each grant, instead of a funding agreement or similar being established with the ARTC, the approach taken by the shareholder departments has been to rely on the broader governance framework that applies to the ARTC as a wholly-Commonwealth owned GBE. In this context, updates on the ARTC's overall capital works program have been provided to the shareholder

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<sup>12</sup> As noted at paragraph 9, the first special grant was awarded by the then Prime Minister in May 2004 as a result of advice to Ministers that DOTARS, in consultation with the ARTC, considered that the highest remaining priority for rail investment was the North NSW Coast line.

<sup>13</sup> See paragraph 19.

departments through quarterly shareholder meetings and half yearly progress reports.

23. Although the ARTC's overall capital works program includes the works being undertaken with the special grants, up until September 2006 the ARTC's reporting did not separately identify the works on which the \$820 million in special grant funding was being used. The reporting also has not identified how the works program has been extended so as to use interest earned on the special grant funds. The result is that DOTARS has not been well placed to monitor the efficiency and effectiveness with which the grant funding the department has paid in advance to the ARTC has been applied. In addition, notwithstanding that the ARTC has recently commenced providing progress reports on the use of the special grants, there is no regime in place requiring the ARTC to acquit the \$820 million in special grants, and the interest earned thereon.

## Improvement opportunities

24. ANAO has made two recommendations, each of which relates to the provision of the three special grants. The recommendations seek to:

- promote improved advice to Ministers where they are considering opportunities to accelerate land transport spending both in terms of the timeframe over which expenditure might be expected to occur and the management of risks where advance payments are made; and
- improve the monitoring and acquittal arrangements for any future special grants.

## Agency responses

25. DITRDLG, Finance and the ARTC provided summary responses to the audit as follows. DITRDLG also provided a more detailed comment, which is included at the appendix to the report.

### DITRDLG

The Department of Infrastructure, Transport, Regional Development and Local Government welcomes the ANAO's findings that the administration and arrangements covering the eight rail grants administered under the *AusLink (National Land Transport) Act 2005* at a total cost of \$155.3 million has been effective.

The Department notes that, for the first of the three untied grants provided by the Government to the ARTC (\$450 million, paid to ARTC on 29 June 2004),

the initial urgent advice requested by the Government reflected limited consultation with ARTC on the scope for possible projects for which funds could be used, should they become available, on the north-south rail corridor. The ARTC subsequently undertook a more detailed advice analysis of the corridor which led to the provision of funding to projects between Sydney and Melbourne as well as the NSW north coast.

The Department accepts the report's two recommendations.

## Finance

The Department of Finance and Administration (Finance) welcomes the ANAO performance report and supports the recommendations.

The Australian Rail Track Corporation (ARTC) is currently undertaking a significant capital and maintenance works programme worth approximately \$2.4 billion (including special grant funds of approximately \$820 million). The current programme of works, which is expected to be largely completed by June 2009, will achieve faster train transit times and an increased market share of the freight transport task between Melbourne, Sydney and Brisbane. This programme is consistent with ARTC's Memorandum of Association which, among other things, requires ARTC to manage track maintenance and construction and to pursue a growth strategy for interstate rail through improved efficiency and competitiveness with the aim to increase rail's share of the interstate freight market. The capital and maintenance programme has been prepared with a view to achieving value for money while ensuring that rail achieves the government's objective of making rail more competitive with road freight.

Finance considers that the Minister should receive appropriate briefings covering all aspects of the subject to enable the Minister to reach a fully informed, balanced and considered decision.

Further, Finance supports appropriate reporting and acquittal arrangements being put in place for future projects funded other than through the land transport legislated funding framework.

That said, Finance notes that ARTC do provide departmental officials with detailed reports on the capital programme, including a detailed breakdown of projects relating to the \$820 million in special grants, on a quarterly basis.

## ARTC

ARTC notes that a substantial proportion of the paper appears based on the premise that the \$820 million of special Government Grants should be subject to the same reporting requirements as if the monies were grants as defined in schedule 3 of the AusLink Act. However, the grants were not provided on this

basis. The non-AusLink grants were provided on the basis that ARTC's charter and the GBE governance arrangements provide the Commonwealth with surety that the funds are invested appropriately.

To that end, ARTC has continued to review its programs and apply those funds in the best interests of the national rail network, and in accordance with ARTC's shareholder-endorsed Corporate Plan. In that context, it has been appropriate for there to be revisions to the manner and timing of application of the monies to ensure that the most appropriate projects were undertaken in a changing environment of funding availability, industry demand and resource availability.

Our investment in the Corridor Improvement Works Program significantly exceeds the amount of the 'special grants' in any event and as such is funded by a combination of the earnings from those pooled investments, combined with funds generated from general operations and accumulated reserves.

Accordingly, all interest earned from the 'special grants' is effectively being invested in the North-South Corridor improvement program.

ARTC also intends to continue to work closely with appropriate shareholder representatives from DOTARS and Department of Finance regarding ongoing reporting of the performance of the investments programs over coming months in accordance with the relevant legislation and agreed processes.

# Recommendations

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*Set out below are ANAO's recommendations and agencies' abbreviated responses. More detailed responses are shown in the body of the report immediately after each recommendation.*

## **Recommendation No.1**

### **Paragraph 3.55**

ANAO *recommends* that, in advising its Ministers on opportunities to accelerate spending on land transport infrastructure works, the Department of Infrastructure, Transport, Regional Development and Local Government:

- (a) appropriately qualify its advice so as to reflect the extent of investigations and analysis that has been undertaken;
- (b) identify the timeframe over which it is expected that Commonwealth funding will be required; and
- (c) propose that payments only be made in advance where there is a net benefit in doing so and subject to appropriate risk management arrangements being put in place.

**DITRDLG and Finance:** Agreed

## **Recommendation No.2**

### **Paragraph 3.69**

ANAO *recommends* that, for any future projects funded other than through the land transport legislated funding framework, the Department of Infrastructure, Transport, Regional Development and Local Government formalise reporting and acquittal arrangements prior to the payment of funds.

**DITRDLG and Finance:** Agreed





## **Audit Findings and Conclusions**



# 1. Introduction

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*This chapter outlines the Australian Government's investment in land transport through the AusLink policy; provides an overview of the role and functions of the Australian Rail Track Corporation; and sets out the audit objective and approach.*

## Background

**1.1** Australian Government spending on land transport is guided by the AusLink White Paper, *'Building Our National Transport Future'*. Under AusLink, a defined National Network of road and rail infrastructure links and their intermodal connections has been established. The AusLink White Paper provided for an investment in the National Network by the Australian Government of \$7.72 billion over the period 2004–05 to 2008–09.<sup>14</sup> This included \$1.8 billion for rail projects,<sup>15</sup> including investments being made by the Australian Rail Track Corporation (ARTC), a wholly-Commonwealth owned Government Business Enterprise (GBE), whose primary role is to provide access to train operators over the parts of the interstate rail network it manages.

**1.2** In the 2006–07 Budget, the then Government announced an additional \$1.82 billion investment in the National Network. The Australian Government's total investment in the National Network is \$10.533 billion.<sup>16</sup> As at September 2007, some nine per cent of this (or \$975.3 million) involved grant funding<sup>17</sup> for the ARTC comprising:

- \$155.3 million for specific projects on the National Network through the AusLink Investment Program<sup>18</sup> administered by the Department of

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<sup>14</sup> AusLink White Paper, *Building Our National Transport Future*, June 2004, p. 75.

<sup>15</sup> AusLink White Paper, *Building Our National Transport Future*, June 2004, p. xii.

<sup>16</sup> AusLink website, <[www.auslink.gov.au](http://www.auslink.gov.au)>, [accessed on 6 September 2007].

<sup>17</sup> A grant is a sum of money given to organisations or individuals for a specified purpose directed at achieving goals and objectives consistent with government policy. In a strict legal sense, a grant is a 'gift' from the Crown, which may, or may not, be subject to unilaterally imposed conditions. Source: ANAO Better Practice Guide, *Administration of Grants*, May 2002, p. 1.

<sup>18</sup> This figure includes only those grant funding amounts that have been approved directly for the ARTC, for works to be carried out by the ARTC. It does not include any amounts that may have been approved for projects in which the ARTC is taking part, but where funding is being provided either directly to, or to the ARTC through or on behalf of, a State Government or other agency.

Infrastructure, Transport, Regional Development and Local Government (DITRDLG);<sup>19</sup> and

- \$820 million in direct lump-sum grants, announced at or around the time of the federal Budgets in 2004–05 (\$450 million), 2005–06 (\$100 million) and 2006–07 (\$270 million). No such funding was included in the 2007–08 Budget.

**1.3** Although both types of ARTC grant funding form part of the Australian Government's \$10.533 billion investment in the AusLink National Network over the period 2004–05 to 2008–09, the governance arrangements in place for the two types of funding are quite different. In summary:

- the \$155.3 million in grants approved for the AusLink National Projects are subject to the provisions of the relevant legislation (the *Australian Land Transport Development Act 1988* (ALTD Act) and the *AusLink (National Land Transport) Act 2005* (AusLink Act)), and to various conditions set out in other documentation supporting the implementation of the legislation; and
- the \$820 million in special grants were not approved under a legislated funding program but, as they involve the expenditure of public money,<sup>20</sup> the payments were subject to applicable financial management legislation.<sup>21</sup>

## The Australian Rail Track Corporation

**1.4** In November 1997, the Australian and mainland State Governments entered into an Intergovernmental Agreement to establish the ARTC to provide a single point of access for the standard gauge interstate rail track (see Figure 1.1). The establishment of the ARTC was part of a major rail reform package by the Australian Government, which also included the sale of the

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<sup>19</sup> Under the Administrative Arrangements Order of 25 January 2008, DITRDLG is responsible for administering the various AusLink funding programs. The administration of its predecessor department, the Department of Transport and Regional Services (DOTARS) is the central focus of this audit.

<sup>20</sup> Public money means money in the custody or under the control of the Commonwealth; or money in the custody of any person acting for and on behalf of the Commonwealth in respect of the custody or control of the money (including such money that is held on trust for, or otherwise for the benefit of, a person other than the Commonwealth) (Section 5, *Financial Management and Accountability Act 1997* (FMA Act)). Public property is similarly defined in the Act.

<sup>21</sup> The payment of the grant funding to the ARTC involves the expenditure of public money by the Australian Government. Once those funds have been received by the ARTC, they are no longer considered to be public money, and are not subject to the financial management legislation that would ordinarily apply.

Australian National Railways Commission and the National Rail Corporation. The objective of the reforms was to respond to rail's decreasing market share by increasing private sector involvement to lower the cost of transport to industry, better meet the needs of customers and provide long term employment in the rail sector.<sup>22</sup> Following the establishment of the ARTC in 1998, the Australian Government allocated \$250 million for specific projects under the Interstate Mainline Upgrade Program to be managed by the ARTC.<sup>23</sup>

**Figure 1.1**

### ARTC rail network



Source: ARTC website <[www.artc.com.au](http://www.artc.com.au)>

<sup>22</sup> *Background – Organisation of Australia's Railways*, <[www.dotars.gov.au](http://www.dotars.gov.au)>, [accessed on 12 March 2007].

<sup>23</sup> As at September 2003, and accounting for indexation of the original funding allocation, \$143.4 million remained unspent under the program. This amount was subsequently paid to the ARTC as an equity injection in June 2004. This funding was committed to by the Australian Government as part of the 60-year lease secured by the ARTC over the NSW interstate and Hunter Valley coal lines on 4 June 2004. The equity injection was provided to assist with the ARTC's investment of \$872 million in the east coast rail corridor that was committed to by the ARTC as part of the NSW Lease.

**1.5** The ARTC is a company incorporated under the *Corporations Act 2001* and is a GBE wholly-owned by the Australian Government. At the time of audit, the then Minister for Transport and Regional Services and the then Special Minister of State<sup>24</sup> represented the Australian Government as shareholders of the company. DOTARS and the then Department of Finance and Administration (Finance)<sup>25</sup> were the departments responsible for administering the reporting and accountability arrangements that facilitate active oversight of the ARTC as a GBE. In this respect, in October 2007 DOTARS advised ANAO that:

As an Australian Government-owned corporation, the [ARTC] Board has clear fiduciary and other responsibilities as set out in a number of key governance documents.

Under the Articles of Association of the company, the powers and duties of the directors of the company are clearly set out. Further, the Memorandum of Association of the company sets out that it is required to comply with the Governance Arrangements for Government Business Enterprises as set out in guidelines issued by the Department of Finance and Administration.

The guidelines include the need for the ARTC to meet a number of reporting requirements including providing annual and six monthly financial reports, a corporate plan and statement of corporate intent, audited accounts and financial statements, and keeping shareholder ministers informed of material effects on the company's value, as well as reinforcing board members' responsibilities.

**1.6** The ARTC commenced operations in 1998 with the following charter:<sup>26</sup>

- improve performance and efficiency of interstate rail infrastructure;
- increase capacity utilisation;
- listen, understand and respond to the market;

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<sup>24</sup> Previously, the then Minister for Finance and Administration was the joint shareholder Minister, rather than the then Special Minister of State. Finance advised ANAO in June 2007 that, as part of a review of his portfolio responsibilities following the announcement of the fifth Howard Ministry on 24 January 2006, the then Minister for Finance and Administration delegated responsibility for the ARTC to the then Special Minister of State. However, the then Minister for Finance and Administration retained responsibility for all Board appointments for the ARTC. The ARTC was formally advised of the change in April 2006.

<sup>25</sup> Under the Administrative Arrangements Order of 25 January 2008, the Department of Finance and Deregulation is responsible for shareholder advice on GBEs. This audit examines the administration of its predecessor department, the Department of Finance and Administration. The Department is referred to as Finance throughout this report.

<sup>26</sup> *Company profile*, ARTC website <[www.artc.com.au](http://www.artc.com.au)>, [accessed on 17 January 2007].

- operate on sound commercial principles; and
- provide shareholders with a sustainable return on capital invested.

**1.7** The ARTC operates in accordance with a number of key documents—namely its Articles and Memorandum of Association, and the Governance Arrangements for GBEs which require the company to meet a range of reporting requirements to its shareholder Ministers, in addition to the provisions of the Corporations Law.

**1.8** The ARTC's primary role is to provide access to train operators over that part of the interstate rail network managed by the company. This includes the provision of train control functions, the creation and selling of train paths to rail operators and the provision of capital and maintenance works over the network.<sup>27</sup>

**1.9** The ARTC receives funding for its operations from a variety of sources. Since it commenced operations in 1998, the ARTC's primary source of revenue from continuing operations has been access revenue.<sup>28</sup> That is, the revenue received by way of fees charged to rail operators for access to the tracks maintained by the ARTC. The ARTC also receives revenue from non-operating activities, which includes interest income and government grants such as those provided under the AusLink Act for AusLink National Projects, and the special grants paid to the ARTC. As Figure 1.2 shows, the special grants received by the ARTC represented a significant increase in the ARTC's revenue.<sup>29</sup>

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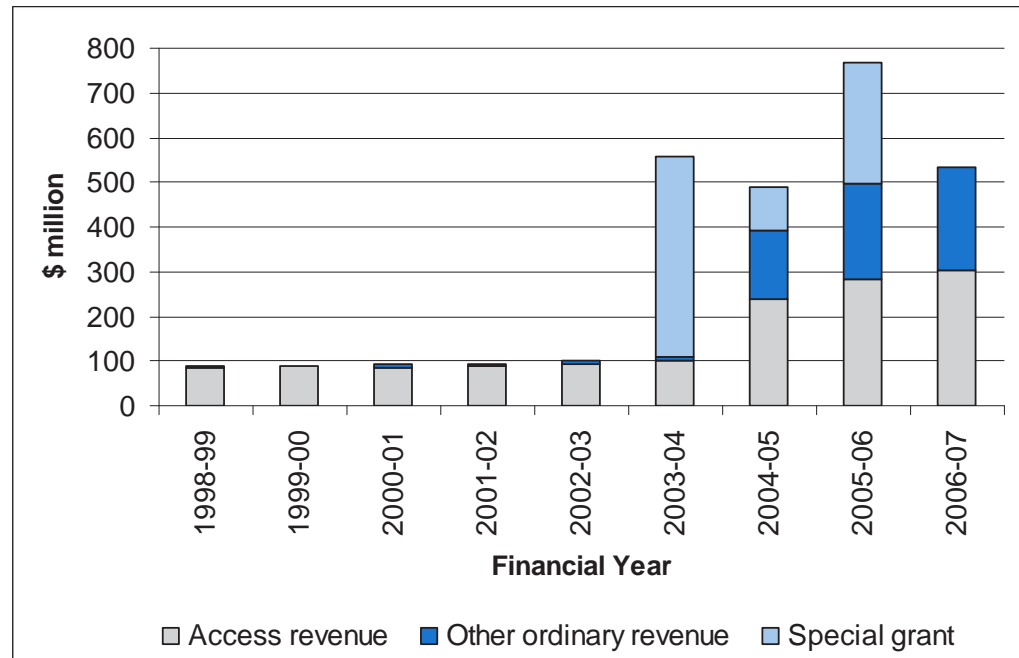
<sup>27</sup> ARTC Annual Report 2005–06.

<sup>28</sup> Source: ARTC annual financial statements 1998–99 to 2006–07.

<sup>29</sup> In each year in which the special grants were received by the ARTC, the ARTC's financial statements have recorded the revenue from the grants as a separate item below 'Profit from continuing operations' in the Income Statement and accompanying Notes.

**Figure 1.2**

**ARTC revenue 1998–99 to 2006–07**



Source: ANAO analysis of ARTC financial statements 1998–99 to 2006–07.

**1.10** Figure 1.2 above illustrates that, between 2003–04 and 2004–05, there was a considerable increase in the access revenue received by the ARTC (from \$100.4 million in 2003–04, to \$238.7 million in 2004–05, an increase of 137 per cent).<sup>30</sup> This increase in access revenue is primarily attributable to the take-up of a 60-year lease of the NSW Interstate and Hunter Valley rail lines by the ARTC, from 5 September 2004. Under the lease agreement, signed with the NSW Government on 4 June 2004, the ARTC commenced management of the interstate and Hunter Valley rail networks in NSW as part of the national interstate network.

## Audit objective and approach

**1.11** The objective of this performance audit was to assess the effectiveness of the administration of grants made to the ARTC. The audit was conducted under Section 18 of the *Auditor-General Act 1997*. The audit examined the special grants made to the ARTC as well as funding provided directly to the

<sup>30</sup> ARTC annual financial statements for 2003–04 and 2004–05.



ARTC under the AusLink Investment Program for projects on the National Network.<sup>31</sup>

**1.12** The audit involved an examination of DOTARS' administration of the grant funding approved for, and paid to, the ARTC (in respect of both types of grant funding). It also involved consideration of the involvement of Finance and the Department of the Prime Minister and Cabinet (PM&C) in advising on the special grant funding and (in respect of Finance) the payment and reporting arrangements for the grants.

**1.13** Each of DOTARS, Finance, PM&C and the Department of the Treasury (Treasury) was provided with a copy of the proposed audit report in November 2007. In accordance with natural justice principles, the ARTC was also provided with a copy of the proposed report and afforded the opportunity to provide comments.<sup>32</sup> Comments on the proposed report were provided by DITRDLG, Finance and the ARTC.

**1.14** The audit was conducted in accordance with ANAO auditing standards at a cost to the ANAO of \$325 000.

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<sup>31</sup> The audit scope did not extend to those projects on the National Network that were being carried out by the ARTC in conjunction with, or on behalf of, State Governments as part of the bilateral agreements between the State and Australian Governments for the delivery of AusLink. AusLink National Project RP0002 was a project included in the Victorian bilateral agreement. However, the project proposal was put forward by, and full funding is to be provided directly to, the ARTC. Accordingly, this project is included in the scope of this performance audit.

<sup>32</sup> Under the *Auditor-General Act 1997*, the Auditor-General may only conduct a performance audit of a GBE, such as the ARTC, if requested by the responsible Minister, Finance Minister, or the Joint Committee of Public Accounts and Audit.

## 2. Grants Governed by Land Transport Legislation

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*This chapter examines DOTARS' administration of the \$155.3 million in ARTC grant funding provided under applicable legislation.*

### Background

**2.1** The AusLink policy was given effect by the *AusLink (National Land Transport) Act 2005* (AusLink Act), which was assented to on 6 July 2005. Parts 3 to 8 of the AusLink Act commenced on 28 July 2005, the date of proclamation by the then Minister for Transport and Regional Services. The *Australian Land Transport Development Act 1988* (ALTD Act), which was the previous primary land transport funding legislation, was effectively superseded by the AusLink Act from this date,<sup>33</sup> with transitional arrangements put in place through the *AusLink (National Land Transport – Consequential and Transitional Provisions) Act 2005* (Transitional Act).<sup>34</sup>

**2.2** Part 3 of the AusLink Act sets out the legislative framework applying to AusLink National Projects. Section 8 of the AusLink Act defines an AusLink National Project as a project for which an approval by the Minister under subsection 9(1) is in force.<sup>35</sup> The transitional arrangements put in place through the Transitional Act included making provision for projects that had been approved under the ALTD Act to be treated as if they had been approved under, and to therefore be administered under, the AusLink Act.<sup>36</sup> As outlined by Table 2.1, there have been seven ARTC projects transitioned to AusLink with one ARTC project approved under the AusLink Act.

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<sup>33</sup> Continuing projects that were approved under the ALTD Act and did not form part of the new AusLink National Network continue to be administered under the ALTD Act.

<sup>34</sup> The Transitional Act made provision for the Minister to determine that certain project approvals that had been made under the ALTD Act were to be taken to be approvals made under the relevant provisions of the AusLink Act. On 12 October 2005, the then Minister for Transport and Regional Services made a determination under the Transitional Act in respect of project approvals to be carried over to the AusLink Act.

<sup>35</sup> Subsection 9(1) of the AusLink Act provides that the Minister may approve a project as an AusLink National Project where he is satisfied that the project is eligible for approval and he considers that it is appropriate to approve the project. Conditions for determining whether a project is eligible and whether it is appropriate to approve the project are set out in sections 10 and 11 of the AusLink Act.

<sup>36</sup> The Transitional Act also amended the ALTD Act to provide that no new approvals of projects or programs under the ALTD Act were to be given by the Minister on or after 28 July 2005 (being the commencement date of Parts 3 to 8 of the AusLink Act).

**Table 2.1****AusLink National Projects approved for the ARTC**

Project name	Date project approved	Approved funding (\$)	Paid to September 2007 (\$)
ARTC1 - Strengthening the Murray River Bridge, Albury, NSW	10 May 2004	3 500 000	141 000
ARTC2 - Strengthening the Murray River Bridge, Murray Bridge, SA	10 May 2004	2 500 000	2 500 000
ARTC3 - New passing loops at Mungala, Haig and Winninowie on the Trans Australian Railway	10 May 2004	3 770 000	3 770 000
ARTC4 - Crossing loops at Mingary, Pt Germein, Matakana and Kinalung	10 May 2004	8 000 000	8 000 000
ARTC5 - Remote control of entry and exit to/from crossing loops on the Trans Australian Railway	10 May 2004	2 600 000	2 585 250
ARTCRAIL001 - Planning for the development of the next generation of train control technology, based on ARTC's Advanced Train Management System	18 Jan 2005	20 317 000	15 733 000
ARTCRAIL002 - Implement CDMA/3G telecommunications across the interstate rail network between Brisbane and Perth	17 Mar 2005	69 600 000	19 633 750
RP0002 - The Tottenham to West Footscray rail link (Tottenham–Dynon upgrade)	12 Feb 2007	45 000 000	18 284 250
<b>Total</b>		<b>155 287 000</b>	<b>70 674 250</b>

Source: ANAO analysis of DOTARS records

**Governance arrangements**

**2.3** As most of the projects approved for the ARTC as AusLink National Projects were originally approved under the ALTD Act, and later transitioned to the AusLink Act by Ministerial Determination, there have been two different pieces of governing legislation for the projects over time. In addition:

- the projects have been subject to various Notes on Administration that have been developed and issued to support the administration of the relevant legislation. The two versions of the AusLink Notes on Administration (issued in October 2005 as a 'working draft' and in final form in March 2006) are not legally binding instruments in their own right. By way of comparison, the Notes on Administration that were determined under Section 37 of the ALTD Act were legally

enforceable.<sup>37</sup> The result is that there are a number of aspects of the AusLink Notes on Administration that are expressed to be conditions with which funding recipients must comply, but there is no legal obligation imposed on the funding recipients to actually comply with those conditions; and

- a Memorandum of Understanding (MoU) was signed between DOTARS and the ARTC on 23 January 2007 in respect of the ARTC's AusLink National Projects. By the time the MoU was signed, 18 months after the AusLink Act commenced,<sup>38</sup> \$46.4 million had been paid to the ARTC for the AusLink National Projects under the land transport legislation. ANAO's examination of DOTARS' records did not show that consideration had been given by DOTARS to establishing an MoU with the ARTC earlier in the implementation of the AusLink Investment Program, or to entering into an enforceable contract or Bilateral Agreement (as had occurred with the States and Territories within six months of the commencement of the AusLink Act). In this respect, in October 2007 DOTARS advised ANAO that:

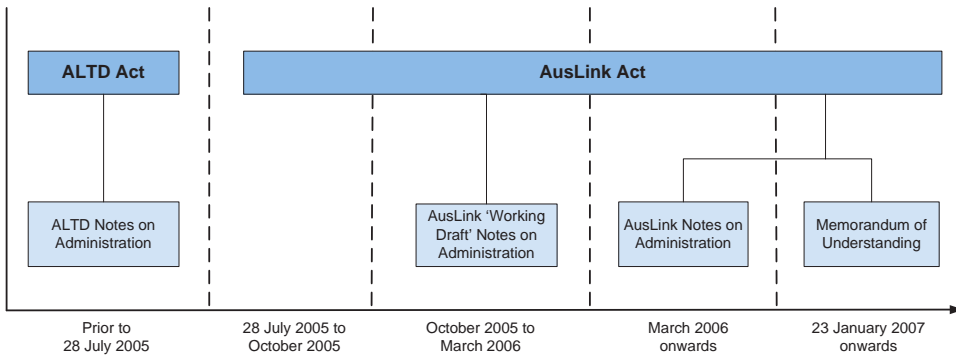
While DOTARS accepts that the Memorandum of Understanding (MOU) with the ARTC took time to put in place, the ARTC was bound by the requirements of the AusLink Act in relation to AusLink payments.

**2.4** The legislation and associated administrative arrangements that have applied to the ARTC's AusLink National Projects over time are illustrated in Figure 2.1.

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<sup>37</sup> The ALTD Notes on Administration were determined in respect of the two major road transport programs administered under the ALTD Act, and did not specifically apply to the ARTC. However, in approving projects for the ARTC, the then Minister for Transport and Regional Services required the ARTC to comply with the ALTD Notes on Administration as a condition of funding for those projects.

<sup>38</sup> DOTARS first sought to establish an MoU with the ARTC in respect of its AusLink National Projects in July 2006.

**Figure 2.1****Legislative and administrative arrangements over time for ARTC projects governed by land transport legislation**

Source: ANAO analysis.

**2.5** Collectively, the legislation, Notes on Administration and MoU provide a sound framework for the administration of the grant funding paid to the ARTC for projects under the land transport legislation.

## Reporting arrangements

### Reporting on project progress

**2.6** The primary reporting mechanism for a funded project under both the ALTD Program and the AusLink Investment Program is the monthly report that is required by the relevant Notes on Administration to be provided by funding recipients to DOTARS. These monthly reports form the basis for payments to be made to funding recipients by DOTARS, and are to contain information relating to the financial progress of the funded projects. ANAO's examination of DOTARS' records showed that, for each payment made to the ARTC in respect of its AusLink National Projects, this calculation was applied as required by the Notes on Administration in arriving at the required payment amount for each project.<sup>39</sup> In addition, the ARTC's forecasts of its expenditure on its AusLink National Projects were, in most instances, reasonably accurate, with actual expenditure only occasionally falling short of

<sup>39</sup> A payment amount is calculated for each approved project, with payment then being made to the ARTC as an aggregate of the individually calculated amounts. Where the calculation resulted in an amount 'owing' to DOTARS in respect of a particular project, this amount was offset from the aggregate payment to be made to the ARTC. No payment was made where the total amounts 'owing' exceeded the aggregate amounts due for payment (that is, the ARTC held a cash surplus).

the forecasts on which payments were made (which occurred mainly in the 2004–05 financial year).<sup>40</sup>

**2.7** The monthly reports are also intended to provide other information about the funded projects to DOTARS. Specifically, in addition to financial information, the reports require funding recipients to provide information to DOTARS that includes:

- the physical progress of the project, including (where relevant) details of significant events or activities that are likely to occur in the coming months;
- details of and reasons for any variations in cost;
- whether there have been any breaches, or alleged breaches, of the National Code of Conduct for the Construction Industry in undertaking projects covered by the code;
- details of tenders to be let; and
- any public recognition opportunities.

**2.8** However, the ARTC has not provided ‘monthly’ reports to DOTARS in every month in which it received or retained Australian Government funding for AusLink National Projects. Specifically, over the 36 months (to September 2007) in which the ARTC should have submitted a report to DOTARS, only 23 reports (64 per cent) were submitted.

**2.9** In addition, the information provided to DOTARS by the ARTC in respect of the progress of its AusLink National Projects has been limited. In particular, up until January 2007, the reports the ARTC provided to DOTARS were not in the format required by the AusLink Notes and did not include any information on the status of the funded projects, other than financial information.<sup>41</sup>

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<sup>40</sup> Specifically, the ARTC’s monthly reports in May and June 2005 reported a considerable increase in the expected total expenditure around that time, but the actual expenditure to the next reports showed that those estimates were not achieved, with actual expenditure falling well short of the forecasts (by as much as \$16 million). This was primarily a result of the ARTC reporting substantial forecast expenditure for one project in those monthly reports, but with no actual expenditure on that project reported until the September 2005 report.

<sup>41</sup> The ARTC reports to DOTARS were in a format similar to, but not the same as, the proforma provided in the ALTD Notes on Administration. Specifically, the column that required funding recipients to report on project progress was not included in the ARTC’s reports to DOTARS. The ARTC continued to report in this format even after the AusLink Act had commenced and two versions of the AusLink Notes had been released.

**2.10** On 8 December 2006, DOTARS contacted the ARTC and requested that, in future, monthly reports be provided in the format required by the AusLink Notes. Further, on 23 January 2007, DOTARS formally wrote to the ARTC on a number of issues, and confirmed that the monthly reports were required to be provided whether the ARTC was seeking payment or not. In this respect, the ARTC has submitted monthly reports in the required format to DOTARS in each month since that time.

**2.11** In relation to progress reporting, in October 2007, the ARTC advised ANAO that:

ARTC acknowledges that reports were not provided every month to DOTARS however this was because it was ARTC's understanding at the time that reports need not be submitted if there was no funding drawdown required...

Once DOTARS requested monthly reports and a particular format, ARTC complied with this request and has submitted monthly reports in the required format to DOTARS in each month since January 2007.

## Variations to approved projects

**2.12** Section 15 of the AusLink Act makes provision for the Minister to vary or revoke a project approval instrument. The AusLink Notes also provide information to funding recipients with regard to changes to the cost and scope of approved projects. Specifically, the AusLink Notes state:

If a change to the scope, cost or timing of a project is required, then a formal proposal for variation will need to be submitted.

The funding recipient will also need to provide an updated benefit-cost analysis for the project. After this advice is received, DOTARS will assess the proposal for variation...

Funding recipients are required to monitor the risk of cost variations and project delays and to address such issues in the monthly progress report. If the cost risk materialises, the funding recipient must write to DOTARS reporting the need for a variation. The report must detail the nature of the variation, why it has occurred and canvas possible responses - including a recommendation...

**2.13** At the time of audit, formal variations had been approved for two of the ARTC's completed AusLink National Projects.<sup>42</sup> The variations related to a

<sup>42</sup> A formal variation was also made to one ongoing AusLink National Project, to increase the scope and approved funding amount. There were a further two projects where the ARTC had advised DOTARS that there would be a 'saving' to the AusLink program as a result of projects being completed under their approved funding limits. However, at the time of audit, no formal variations had been made to the project approval instruments for these projects.

change in the scope of the projects, with a reduction in the approved funding amount for one of the projects. Rather than identifying to DOTARS in its monthly reports that variations were required for the two projects, the ARTC requested the variations through a project closure report, in January 2007.

**2.14** At the time the variations were requested, the works had already been undertaken by the ARTC, without prior approval for the revised scope of the project. Specifically, the works undertaken as part of the revised project scope had been completed for between six months and 17 months before the ARTC requested the variations. As the additional works were undertaken without prior approval, there is a risk that the ARTC expended the funds in respect of those additional works in contravention of the AusLink Act, as the AusLink Act stipulates that grant funding may only be expended on the approved project. Nonetheless, the variations were approved on 5 February 2007. On 8 February 2007, DOTARS wrote to the ARTC advising of the variation approvals and stated:

Please note that to reduce the risk to the ARTC bearing the cost of project variations under the AusLink programme, formal approval should be sought for all variations to the scope and/or increased cost of AusLink projects to be funded by the Australian Government prior to implementing the variation.

**2.15** In October 2007, the ARTC advised ANAO that:

The variations referred to were to reduce the approved funding amount for one of the projects. ARTC is keen to ensure that it continues to comply with all aspects of the funding or related requirements. To that end if there are any other aspects that require attention we request that we are notified accordingly.

## **Closure reporting**

**2.16** The monthly reporting process is also designed for funding recipients to report to DOTARS when a project has been completed, both physically and financially. Specifically, the AusLink Notes state:

A project is considered completed as soon as it achieves its primary purpose – for example, a new road opens for traffic or a rail passing loop becomes operational... DOTARS considers an AusLink National Project to be finalised when Australian Government funding has been fully expended on the project and all revenue from the sale of surplus land payable to the Australian Government has been refunded or reallocated in line with the requirements detailed [in these Notes].



Funding recipients are required to advise DOTARS through the monthly report when a project is completed and when all outstanding payments and receipts are finalised...

Within a month of the completion of Australian Government funding for a project, the funding recipient is to provide a written statement to DOTARS confirming that there are no outstanding payments or receipts for the project.

**2.17** At the time of audit, there were three ARTC National Projects that had been completed and for which Australian Government payments had been finalised. However, DOTARS has not obtained timely completion reports, or obtained other information required by the AusLink Notes. Specifically:

- projects had been completed for between five and nine months before being reported in the ARTC's monthly reports as completed (see Table 2.2); and
- written statements were not obtained by DOTARS confirming that there were no outstanding receipts or payments for the completed projects once Australian Government funding had been finalised.

**2.18** Following a request from DOTARS in early December 2006, a project finalisation report was provided to DOTARS by the ARTC on 18 January 2007. The report provided details on the three projects that had been completed by the ARTC, including the works undertaken, and the dates of completion of the projects. As Table 2.2 shows, at the time the project finalisation report was received by DOTARS in January 2007, the projects had been physically completed for between five months and more than a year-and-a-half.

**Table 2.2****Reporting on completed ARTC AusLink National Projects**

Project	Date project physically completed	First monthly report in which project reported as complete
ARTC2 – Strengthening the Murray River Bridge, Murray Bridge, SA	June 2005 <sup>A</sup>	March 2006
ARTC3 – New passing loops at Mungala, Haig and Winninowie on the Trans Australian Railway	August 2005	March 2006
ARTC4 – Crossing loops at Mingary, Pt Germein, Matakana and Kinalung	August 2006 <sup>B</sup>	January 2007 <sup>C</sup>
<p>Notes:</p> <p><sup>A</sup> The ARTC's report of 18 January 2007 did not specify a date of physical completion for this project. However, the ARTC's 2004–05 Annual Report stated that this project was completed in June 2005.</p> <p><sup>B</sup> The ARTC's report of 18 January 2007 stated that the final works in this project were commissioned on 26 August 2006, but that there was some 'fine tuning' of the signalling systems to be completed and some 'track and civil housekeeping' work to be finalised at one of the sites. However, the AusLink Notes state that DOTARS considers a project to be completed when it has achieved its primary purpose (e.g. the rail loop becomes operational) and this occurred for the last site in August 2006.</p> <p><sup>C</sup> The monthly reports provided to DOTARS by the ARTC between January 2007 and April 2007 reported this project as complete, with some 'fine tuning' and 'civil housekeeping' work still outstanding. The project was reported as fully complete in the ARTC's May 2007 monthly report.</p>		

Source: ANAO analysis of DOTARS records

## Accountability arrangements

**2.19** Under both the ALTD Act and the AusLink Act, funding recipients have been required to provide an annual audited financial statement, or statement of expenditure, for each financial year in which they spent or retained Australian Government funds for the relevant projects. The provisions in each Act are largely similar, requiring the provision of the same types of information by the funding recipient. Section 21 of the AusLink Act states:

For each financial year in which the funding recipient spends or retains any of the funding payment, the funding recipient must give to the Minister as soon as practicable, and in any event within 6 months, after the end of that year:

- a) a written statement as to:
  - (i) the amount spent by the funding recipient during that year out of the funding payment; and
  - (ii) the amount retained by the funding recipient out of the funding payment as at the end of that year; and

- b) a report in writing and signed by the appropriate auditor<sup>43</sup> stating whether, in the auditor's opinion:
- (i) the statement is based on proper accounts and records; and
  - (ii) the statement is in agreement with the accounts and records; and
  - (iii) the expenditure referred to in subparagraph (a)(i) has been on the funded project.

**2.20** The ALTD Notes on Administration and the AusLink Notes provided proformas for funding recipients to use in submitting the annual statements. Both Notes on Administration also imposed an additional requirement on funding recipients that a statement by the Chief Executive Officer (CEO) also be provided, certifying, among other things, that:

- the amounts expended have been wholly expended on approved purposes and only on eligible costs;<sup>44</sup>
- tenders for funded works have been dealt with in the appropriate manner in accordance with the relevant legislation; and
- funding recipients have met the requirements of the National Code of Practice for the Construction Industry.

**2.21** The ARTC received funding for its AusLink National Projects in two financial years for which an audited statement was due at the time of audit, namely 2004–05 and 2005–06.<sup>45</sup> For 2004–05, the statement was required to be provided under the ALTD Act. In early February 2006, seven months after the end of the 2004–05 financial year, DOTARS raised with the ARTC that the audited statement was yet to be provided. A draft statement was provided to DOTARS by the ARTC in late March 2006. However, the draft statement contained discrepancies in the actual funding amounts received by the ARTC,<sup>46</sup> and was not accompanied by the audit report required by the ALTD Act. In early April 2006, DOTARS advised the ARTC by email that:

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<sup>43</sup> The AusLink Act defines the term 'appropriate auditor'. In the ARTC's case, the appropriate auditor to provide the report is the Auditor-General.

<sup>44</sup> Up until the signing of the MoU in January 2007, there was no definition of the types of costs that were eligible and ineligible for Australian Government funding for the ARTC's AusLink National Projects.

<sup>45</sup> The ARTC also received funding for its AusLink National Projects in 2006–07. However, the audited statement in respect of the funds spent or retained in that year is not due until 31 December 2007.

<sup>46</sup> These discrepancies were raised by DOTARS with the ARTC, and the final audited report provided by the ARTC contained the correct figures.

Further to our conversations regarding the audited certificate of the AusLink funding received by the ARTC, we have been advised by our finance area that no further AusLink payments can be made to ARTC until that certificate is received. This includes the most recent claim submitted.

**2.22** The audited financial statement for 2004–05 was finalised on 20 June 2006, almost a full year after the end of the financial year to which it related. Claims for payment were submitted by the ARTC in March, April and May 2006, however, as the statement had not been submitted as required, funding was withheld by DOTARS until receipt of the finalised report.

**2.23** The ARTC's audited statement for the 2005–06 financial year was provided as required by the AusLink Act and the AusLink Notes on 18 January 2007.<sup>47</sup> In October 2007 the ARTC advised ANAO that:

ARTC acknowledges that there was a delay in the submission of an approved audited financial statement for 2004/05 ALTD/AusLink related projects. ARTC was not aware of this requirement, but as soon as it was brought to ARTC's attention, appropriate steps were taken to arrange for the necessary audit and report to be prepared...

Arrangements for preparation of the audited statement for the 2006/07 financial year are currently being made and ARTC anticipates no difficulty in supplying the appropriate report by the required deadline of 31 December 2007.

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<sup>47</sup> ANAO notes that this report was submitted shortly outside the six month timeframe specified in the AusLink Act. However, no claims for payment from the ARTC were affected by the delay.

## 3. Special Grants

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*This chapter examines the administration of \$820 million paid to the ARTC in three separate special grants between 2004 and 2006.*

### Background

**3.1** Approving funding for a discretionary grant involves a commitment to spend public money. The financial framework governing commitments to spend public money reflects sound principles that have evolved over time. Specifically, Part 4 of the *Financial Management and Accountability Regulations 1997* (FMA Regulations), *Commitments to spend public money*, sets out a hierarchy of requirements that must each be satisfied, in the appropriate sequence, in order for a commitment to spend public money to be lawfully entered into. This includes requirements that:

- a grant not be approved (by Ministers or authorised officials)<sup>48</sup> unless reasonable inquiries have been undertaken that demonstrate that the proposed expenditure will make efficient and effective use of public money (FMA Regulation 9);
- the terms of the approval be documented (FMA Regulation 12); and
- officials that subsequently enter into a contract, agreement or arrangement under which public money is, or may become, payable are obliged to give effect to any terms of the funding approval given in accordance with FMA Regulation 9 (FMA Regulation 13).

**3.2** Between June 2004 and June 2006, \$820 million has been paid to the ARTC in three separate special grants. The first two special grants (of \$450 million and \$100 million) were approved by the then Prime Minister in May 2004 and June 2005 respectively. The third grant (of \$270 million) was approved by senior Ministers (including the then Prime Minister) in April 2006.

### May 2004: \$450 million grant

**3.3** In the context of the 2004–05 Budget, DOTARS, Finance and the Department of the Treasury (Treasury) were asked to contribute advice to the Department of the Prime Minister and Cabinet (PM&C) concerning the scope

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<sup>48</sup> FMA Regulation 3 defines an approver as: a Minister; or a Chief Executive; or a person authorised by or under an Act to exercise a function of approving proposals to spend public money.

and practicality of making payments in 2003–04 across a range of areas of government activity, most of which had been the subject of earlier advice to Ministers. The advice was sought in the context of senior Ministers giving consideration to the scope for possible measures to draw down a higher than budgeted 2003–04 surplus. This is not an uncommon practice when budget surpluses exceed forecasts but it requires particular attention by departments to providing sound advice, a focus on giving effect to the terms of any decisions made by Ministers and, once payments are made, effective management of risks to the outcomes sought.

**3.4** On 1 May 2004, departments provided advice to Ministers on a possible grant of \$450 million to the ARTC for rail re-alignments on the North NSW Coast line. The advice to Ministers addressed:

- the merits of providing increased funding for economically warranted projects on the ARTC rail network; and
- the effect of alternative payment options (for example, grants and equity injections) on the underlying Budget cash balance.

**3.5** In this context, advice to the then Prime Minister was that DOTARS, in consultation with the ARTC, considered that the highest remaining priority for rail investment was the North NSW Coast line. In respect to this advice, in October 2007, DOTARS advised ANAO that:

The ARTC were asked to provide oral advice on the areas of the interstate network where possible projects might be undertaken should funding become available and they responded accordingly.

When the ARTC was formally advised of funding by the shareholder Ministers it subsequently provided an indicative list of projects in formal advice to Ministers on 26 May 2004 and that it would in due course settle the final projects to be pursued.

**3.6** As illustrated by Figure 1.2 in Chapter 1 of this audit report, additional funding of up to \$450 million<sup>49</sup> represented a substantial injection of funding to the ARTC.<sup>50</sup> However, in consulting with the ARTC, DOTARS did not seek

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<sup>49</sup> Initial advice to Ministers canvassed a grant of \$350 million. The final advice was in relation to a possible grant of \$450 million.

<sup>50</sup> In its 2004 Annual Report (p. 4), the ARTC stated that: 'The overlay of these investments [*the \$872 million associated with the NSW lease, the \$450 million special grant and \$550 million for rail related investment under the AusLink legislation*] will require significant co-ordination and planning to enable the optimisation of the infrastructure upgrades to lift rail's performance. To this end ARTC will in the first half of 2004–05 remodel the infrastructure investment alternatives for the North South corridor so that the maximum benefit is obtained from these investments and the resulting improvement in rail's cost effectiveness and performance is translated into market growth.'

advice on the likely works program for additional funding of such a magnitude. DOTARS also did not seek advice from the ARTC on the timeframes over which funds of up to \$450 million could be expended by the ARTC on rail infrastructure improvements.<sup>51</sup>

**3.7** In light of the advice provided by DOTARS, on 3 May 2004, the then Prime Minister agreed to a recommendation that \$450 million be paid to the ARTC by 30 June 2004 for rail re-alignments on the NSW North Coast line. The next day, the then Prime Minister wrote to the then Minister for Transport and Regional Services.<sup>52</sup> The grant was announced on 11 May 2004 as an expense measure for the Transport and Regional Services portfolio in the 2004–05 Budget Papers (see Figure 3.1).

**Figure 3.1**

**Budget announcement of \$450 million special grant**

<b>AusLink — grant to the Australian Rail Track Corporation</b>				
<b>Expense (\$m)</b>				
	<b>2004-05</b>	<b>2005-06</b>	<b>2006-07</b>	<b>2007-08</b>
Department of Transport and Regional Services	-	-	-	-

The Government will provide a grant of \$450 million to the Australian Rail Track Corporation (ARTC) in 2003-04 for investment in new rail infrastructure projects on the interstate rail system, including improvements and rail realignments on parts of the NSW north coast line to Brisbane. This is in accordance with the ARTC charter to develop interstate rail freight and will improve rail's ability to compete with road freight.

Source: Budget Measures 2004–05, Budget Paper No.2, Circulated by the Honourable Peter Costello MP Treasurer of the Commonwealth of Australia and Senator the Honourable Nick Minchin Minister for Finance and Administration for the Information of Honourable Members and on the Occasion of the Budget 2004–05, 11 May 2004, p 246.

<sup>51</sup> The preliminary program of works later developed by the ARTC proposed the delivery of projects over a period of five years.

<sup>52</sup> The then Prime Minister's letter stated: '*I am advised that your department, in consultation with the ARTC, considers that a high priority should be placed on rail re-alignments on the North NSW Coast line. This investment would achieve increased superfreighter speeds and make rail a more viable alternative to road freight. Accordingly, I request that you provide \$450 million towards rail re-alignments as a grant to the ARTC by 30 June 2004.*' The then Prime Minister also asked to be advised of '*details of the nature and composition of this rail re-alignment programme*'.

### **June 2005: \$100 million grant**

**3.8** In the context of preparations for the subsequent 2005–06 Budget, a proposal on a range of options regarding budget measures that could be implemented prior to 30 June 2005 was put to the then Prime Minister. Included in this proposal was an option for a \$100 million grant to the ARTC to contribute to the ARTC's investment in the upgrade of the Melbourne-Sydney-Brisbane rail corridor through its \$1.3 billion East Coast Rail Upgrade program (also referred to as the North-South Corridor Strategy, released by the ARTC in May 2005). On 23 June 2005 the then Prime Minister agreed to a recommendation that a grant of \$100 million be provided to the ARTC prior to 30 June 2005 for investment in the north-south rail corridor. The grant was announced in a press release by the then Minister for Transport and Regional Services on 5 July 2005.

### **April 2006: \$270 million grant**

**3.9** In mid-December 2005, central agencies provided advice to the then Prime Minister and senior Ministers in response to their request for options on road and rail funding that could be brought forward into 2005–06. On 27 April 2006, senior Ministers (including the then Prime Minister) met and agreed that funding of \$270 million would be provided to the ARTC to improve rail track quality on the North-South rail corridor through targeted concrete re-sleepering, specifically for the Melbourne-Sydney-Junee sections and the Newcastle to Queensland border sections of the corridor. Funding was to be provided subject to the then Minister for Transport and Regional Services commencing negotiations to ensure that the \$270 million could be productively expended in 2005–06.

**3.10** The grant was announced on 9 May 2006 as an expense measure for the Transport and Regional Services portfolio in the 2006–07 Budget Papers (see Figure 3.2).



**Figure 3.2****Budget announcement of \$270 million special grant**

<b>Investing in the nation's infrastructure — improving the national rail track</b>				
Expense (\$m)	2006-07	2007-08	2008-09	2009-10
Department of Transport and Regional Services	-	-	-	-

The Government will provide \$270.0 million to the Australian Rail Track Corporation in 2005-06 to assist with investment in Australia's interstate rail network. The Australian Rail Track Corporation aims to improve the rail track quality by re-sleeper sections on the North South rail corridor. This investment will improve track performance and reduce long-term maintenance costs on national rail corridors, increasing the competitiveness of freight rail.

Source: *Budget Measures 2006–07*, Budget Paper No.2, Circulated by the Honourable Peter Costello MP Treasurer of the Commonwealth of Australia and Senator the Honourable Nick Minchin Minister for Finance and Administration for the Information of Honourable Members and on the Occasion of the Budget 2006–07, 9 May 2006, p 318.

## Governance arrangements

**3.11** In the absence of legislation mandating the conduct and conditions applied to grant programs and individual grants, a funding agreement is often used.<sup>53</sup> In this context, in a number of instances where the Australian Government has decided to make advance payments relating to spending on land transport infrastructure, the funding recipient has been required to agree to administrative arrangements to govern the provision and use of the funds prior to any payments being made. For example:

- additional funding of \$1.82 billion for roads projects under the AusLink Investment Program was announced in the 2006–07 Budget, to be paid before 30 June 2006. It was announced that the funding was subject to relevant State and Territory Governments entering into MoU's with the Australian Government;<sup>54</sup> and
- in the 2007–08 Budget, supplementary funding of \$250 million was announced for the Strategic Regional Program, to be paid in 2006–07. It

<sup>53</sup> ANAO Better Practice Guide, *Administration of Grants*, Canberra, May 2002, p. 49.

<sup>54</sup> 2006–07 Budget Paper No.2, *Budget Measures 2006–07*, circulated by the Honourable Peter Costello MP Treasurer of the Commonwealth of Australia and Senator the Honourable Nick Minchin Minister for Finance and Administration for the information of Honourable Members on the occasion of the Budget 2006–07, 9 May 2006.

was announced that funding recipients would be required to conclude funding agreements with the Australian Government prior to 30 June 2007.<sup>55</sup>

**3.12** However, in respect of the three special grants paid to the ARTC, there are no contracts, funding agreements or arrangements that require the ARTC to use the \$820 million in grant funding on any particular projects or in any particular timeframe. The absence of funding agreements or other grant-specific governance arrangements is a direct consequence of steps taken by the shareholder departments to assist in positioning the ARTC to treat the first special grant as non-assessable for taxation purposes.

### **Taxation considerations**

**3.13** In respect to the first special grant (of \$450 million), the then Prime Minister was advised that a grant to the ARTC would normally attract company tax, but that the ARTC's tax credits and trust fund arrangements may reduce net tax payable on the grants. However, following the then Prime Minister's approval of the first special grant, DOTARS and Finance, in consultation with the ARTC, undertook analysis that sought to minimise any diminution through taxation effects of the cash available to the company to spend on rail improvements. In this respect, on 4 May 2004, the ARTC advised DOTARS that:

Our advice is that the appropriation of funds to ARTC directly should adopt the following criteria:

- The Commonwealth will make a payment in the form of a gift or donation to ARTC.
- The payment will be specifically appropriated to ARTC under Commonwealth legislation...
- If necessary for the purposes of the appropriation, reference could be made to the purpose of furthering ARTC's charter of improving interstate rail infrastructure. However, it is essential that the gift be absolutely unconditional, to prevent the payment by the Commonwealth to ARTC being viewed as tied to a condition or obligation (whether express or implied) imposed on ARTC in respect of the use of the payment, which would give rise to a risk that the payment would be subject to a 30% income tax levy.

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<sup>55</sup> See Media Release TRS09/Budget Joint, *Regional Roads: Building for the Future*, Minister for Transport and Regional Services and Minister for Local Government, Territories and Roads, 8 May 2007.

- Hence, ARTC will have no legal or contractual obligation in relation to the use of the payment. Further, ARTC will have an absolute discretion over the manner in which the payment may be applied.
- The payment will be a “one-off” payment (and not a periodic payment e.g. as works progressed), so that it does not meet one of the tests of ‘income’; and
- The payment will be expressed to be made to the ARTC outside the course of its business and without any connection with specific business activities of ARTC, again so as not to fall within a definition of ‘income’.

**3.14** In the context of the ARTC’s advice, on 5 May 2004 DOTARS advised Finance that:

We are currently exploring with ARTC a means to minimise its tax exposure by drafting a letter from shareholder Ministers to the ARTC asking it to nominate appropriate projects (on the north south rail link) and in accordance with the PM’s request to report back to him on the proposed projects.

I am advised that should we nominate a project eg north coast rail line this will make it much more likely that ARTC will pay tax (income and GST) on the first transaction, ie transfer of funds to ARTC. This could reduce the amount to around \$250m.

**3.15** In relation to the letter prepared for the then shareholder Ministers to send to the ARTC advising of the first special grant, DOTARS advised the then Minister for Transport and Regional Services that:

The letter has been deliberately drafted so as to allow ARTC the opportunity to employ the funds in the most tax effective way in order to ensure that the benefits to the rail freight industry are maximised.

**3.16** Significantly, Treasury was not consulted on the merits of this approach. By way of comparison, in July 2004, when preparing the draft AusLink legislation, DOTARS sought advice from Treasury as to whether AusLink grant payments (particularly those to the ARTC and taxable non-government entities) should be made non-assessable or exempt income. Treasury advised DOTARS that:

If AusLink grants were to be made tax exempt, a consequential change would need to be made to prevent grantee entities (and associated entities that might subsequently hold the resulting infrastructure) from claiming depreciation deductions in respect of infrastructure acquired from expending the grant. This would require complex restrictions on the use of grant monies within corporate groups and, most likely, a new complex regime to trace subsequent

ownership of the resulting infrastructure assets and apply appropriate tax treatment to changes of ownership. In the latter case this may require a special regime to deal with what might otherwise be an inappropriate treatment arising from the interaction of capital allowance, balancing charge and capital gains tax regimes. We can elaborate on these likely complexities should you wish. However, we would note our very strong preference not to adopt such a complex course because it would further add to the already heavy compliance burden arising from our tax laws.

**3.17** Subsequently, DOTARS advised the then Minister for Transport and Regional Services that financial assistance provided to the ARTC for projects under the AusLink Act would be treated as assessable income for tax purposes, thereby reducing the value of assistance in the short term, although expenditure on capital improvements could be claimed as a depreciation expense over time. There was no reconsideration of the approach taken with respect to the first special grant.

**3.18** The taxation treatment of the special grants was raised by ANAO in the context of ANAO's audit of the ARTC's 2005–06 financial statements. Specifically, in August 2006, ANAO highlighted that an Australian Taxation Office ruling may be required in order to definitively conclude that the three special grants should be excluded from the company's assessable income.

**3.19** In October 2007, as part of this performance audit, ANAO sought the ARTC's advice as to whether the company had sought a ruling on the taxation treatment of the three special grants. The ARTC advised ANAO in January 2008 that, having considered professional advice in 2004, 2005 and 2006, the ARTC has not sought a ruling on the taxation treatment of the three special grants.

## **Development of the program of works**

**3.20** The documents that have recorded the approval of each of the three special grants have detailed a specific purpose for which the funding was expected to be applied by the ARTC. Specifically:

- the first grant (of \$450 million) was to be spent on rail re-alignments, with high priority on rail re-alignments on the North NSW Coast line;
- the second grant (of \$100 million) was to be spent as part of the ARTC's East Coast Rail Upgrade program (also referred to as the North-South Corridor Strategy, released by the ARTC in May 2005); and

- the third grant (of \$270 million) was to be used to improve track quality on the North-South rail corridor through targeted concrete re-sleepering for the Melbourne-Sydney-June sections and the Newcastle to Queensland border sections.

**3.21** FMA Regulation 13 requires that any contract, agreement or arrangement entered into by a departmental official conform with the spending proposal approved by the Minister. However, as noted, in order to assist in positioning the ARTC to treat the grants as non-assessable for taxation purposes, there are no contracts, funding agreements or arrangements that govern the ARTC's use of the \$820 million in special grants. In this respect, in October 2007, Finance,<sup>56</sup> DOTARS<sup>57</sup> and the ARTC<sup>58</sup> each advised ANAO that the grants were untied and that the ARTC's charter and the GBE governance arrangements provide the Commonwealth with surety that the funds are invested in the best interests of the national rail network and in accordance with the shareholder-approved Corporate Plan.

**3.22** The approach taken by the shareholder departments to rely on the broader company governance framework to oversight the use of the special grant funding is particularly germane with respect to the first (\$450 million) grant. This is because this grant established the framework under which the

<sup>56</sup> Finance advised ANAO that: 'As a wholly owned Australian Government business ARTC is subject to accountability and reporting framework that is, in many cases, not generally associated with grant recipients. This reporting framework comprises both legislation (*Commonwealth Authorities and Companies Act 1997*) and policy (the Governance Arrangements for Commonwealth Business Enterprises [June 1997]). Under this framework ARTC, on an annual basis, provides its Shareholder Ministers with a Corporate Plan (Plan) and the Statement of Corporate Intent, as well as six monthly performance reports. In particular, the Plan provides Ministers with, among other things, updates on the investment programme together with forecasts for future spending. In this context, the six monthly report also provides updates on the progress against the Plan's investment programme and key performance targets. Additionally, ARTC meets with the Shareholder departments quarterly and provides detailed reporting on its investment programme which includes the \$820 million in grants funds.'

<sup>57</sup> DOTARS advised ANAO that: 'As an Australian Government-owned corporation, the Board has clear fiduciary and other responsibilities as set out in a number of key governance documents. Under the Articles of Association of the company, the powers and duties of the directors of the company are clearly set out. Further, the Memorandum of Association of the company sets out that it is required to comply with the Governance Arrangements for Government Business Enterprises as set out in guidelines issued by the Department of Finance and Administration. The guidelines include the need for the ARTC to meet a number of reporting requirements including providing annual and six monthly financial reports, a corporate plan and statement of corporate intent, audited accounts and financial statements, and keeping shareholder ministers informed of material effects on the company's value, as well as reinforcing board members' responsibilities. Consistent with this framework, shareholder ministers requested and received advice from the ARTC as to how the special grant funds would be applied.'

<sup>58</sup> The ARTC advised ANAO that: 'ARTC is a wholly-owned Commonwealth company and is prescribed as a Government Business Entity under the Commonwealth Authorities and Companies Act. The grants were provided as gifts, on the basis that ARTC's charter and the GBE governance arrangements provide the Commonwealth with surety that the funds are invested in the best interests of the national rail network and in accordance with the shareholder-approved Corporate Plan.'

two later grants were paid. In addition, there are significant differences between the intended purpose of grant funding advised to the then Prime Minister when he approved the first special grant, and the use to which these funds are being put.

**3.23** In relation to the first special grant, the proposal that was approved by the then Prime Minister in May 2004 involved a \$450 million grant for rail re-alignments on the North NSW Coast line. Consistent with this funding purpose, DOTARS’ 2003–04 Annual Report included the grant as an administered program that was to reduce rail transit time between Sydney and Brisbane through expenditure on rail re-alignments on parts of the NSW North Coast line to Brisbane (see Figure 3.3).

**Figure 3.3**

**\$450 million grant as an administered program**

Administered programme – AusLink – Grant to the ARTC (Programmes Group)		
Description	Performance indicators <sup>5</sup>	Progress
This one-off grant will enable the ARTC to invest in rail infrastructure including rail realignments on parts of the NSW north coast line to Brisbane.	<i>Effectiveness:</i> reduction in rail transit time between Sydney and Brisbane  <i>Cost:</i> \$450.0m	✓✓✓

This one-off grant will enable the ARTC to invest in rail infrastructure, particularly the unreliable NSW north coast line. The average speed of trains on the north coast line is currently just 47 kilometres an hour.

Better track conditions will reduce the time it takes for freight trains to travel between Sydney and Brisbane by at least 3 hours, and will make rail more competitive on this key route.

Source: DOTARS Annual Report 2003–04, p.77.

**3.24** As noted at paragraphs 3.4 to 3.6, limited work had been undertaken by DOTARS or the ARTC<sup>59</sup> in respect to the likely use by the ARTC of \$450 million in funding for rail infrastructure prior to the then Ministers being advised that a \$450 million special grant could be made for rail re-alignments on the North NSW Coast line. As a result of the taxation considerations mentioned above, the letter from the then shareholder Ministers to the ARTC advising of the grant was deliberately drafted by DOTARS and Finance so as

<sup>59</sup> In October 2007, ANAO sought from the ARTC a copy of any advice the company provided to DOTARS (if it was in writing) or advice on the content of the advice (if it was not in writing). The ARTC advised ANAO it had no comments to make on this issue.

not to specify that the \$450 million was to be spent on rail re-alignments on the North NSW Coast line. Rather, the correspondence stated that the funding was being provided:

for use in accordance with the objectives for which the company was established.<sup>60</sup>

**3.25** In addition, the correspondence asked the ARTC to inform the shareholder Ministers of the highest priority investments that could be undertaken with the additional funding being provided.

**3.26** On 21 May 2004, the ARTC provided DOTARS with a draft works program titled 'Sydney to Brisbane: North Coast Corridor Upgrade Program—Briefing Paper'. Subsequently, on 26 May 2004, the ARTC provided the then shareholder Ministers with an 'indicative program' of works that could be undertaken with the additional funding. The program comprised 23 projects, with all but \$55 million allocated to projects north of Newcastle, although not all of the identified projects related to rail re-alignments. The ARTC advised that:

The projects are to undergo rigorous modelling and evaluation by ARTC management with train operators and other stakeholders to determine that they achieve the maximum benefits for the investment.

It is anticipated that the detailed evaluation and modelling will be completed over the next four months. This should enable the Board to make conclusive commitments to the detailed projects and program for undertaking the works.

**3.27** The indicative list of projects was provided to the then Prime Minister<sup>61</sup> on 27 May 2004. The then Minister for Transport and Regional Services advised the then Prime Minister that:

The ARTC has provided a preliminary programme of 23 projects from Hornsby in Sydney to Acacia Ridge in Brisbane to be built over the next 5 years. These projects have been identified after consultation with Pacific National, Queensland Rail, RailCorp and SCT. The programme is still subject to some further refinement to ensure that it addresses deficiencies in the corridor at the most optimal cost and benefit for rail's market development.

<sup>60</sup> As noted, DOTARS had advised the then Minister for Transport and Regional Services that this correspondence to the ARTC had been deliberately drafted to allow the ARTC to employ the funds in the most tax effective way.

<sup>61</sup> In advising of the decision to provide the \$450 million special grant, the then Prime Minister had asked to be advised of the details and composition of the rail realignment program that was to be undertaken with the funds.



**3.28** DOTARS did not advise its then Minister that the indicative program had yet to undergo detailed analysis and modelling, or indicate that not all of the projects identified were rail re-alignments (which were the works that the then Prime Minister had specified in his approval of the grant). Accordingly, this information was also not conveyed to the then Prime Minister.

**3.29** In September 2004, PM&C raised concerns with DOTARS that the projects to be undertaken by the ARTC with the first special grant were not wholly consistent with those that had been put to the then Prime Minister when he approved the grant. Specifically, PM&C records provided to ANAO state that it was concerned that the final project list included projects not located on the North Coast of NSW and that did not involve rail re-alignments. PM&C also emphasised to DOTARS the importance of departments identifying the best projects and implementing arrangements that deliver on what Ministers have agreed.

**3.30** On 27 May 2005, 12 months after the ARTC produced its indicative program of works, the company provided DOTARS and Finance with an updated program of works referred to as the North-South Corridor Strategy. The ARTC advised the shareholder departments that, having now undertaken the detailed analysis of the proposed program of works, it had concluded that the strategy that would best achieve the maximum market share change and minimise risk was in fact a significant program of passing lanes to be constructed between Melbourne and Junee, and not the initially proposed works on the NSW North Coast.<sup>62</sup> In this respect, in October 2007, DOTARS advised ANAO that:

As outlined in the shareholder letters to the ARTC advising of each of the three special grants, the special grants were provided on an untied basis and were not subject to approval by the shareholder ministers as to how the funds should be expended...

The ARTC has kept shareholder representatives fully informed of their intended application of the special grant funds and any changes to previous advice as circumstances have changed. For example, in relation to the \$450 million special grant, on 21 May 2004 ARTC provided an indicative programme of works for application of the funds, subject to detailed modelling and evaluation with their customers and stakeholders.

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<sup>62</sup> The ARTC also advised that, in addition to the works on the Melbourne to Junee line, there would also be an increase in the number of loop extensions on the north coast which would further reduce transit times and increase reliability on the north-south corridor.



Over the course of the following 12 months, ARTC undertook a review of their North–South Investment Strategy which identified a shift in the initial focus of application of the funds.

ARTC advised DOTARS and central agencies of the shift in focus at a meeting in Canberra held on 27 May 2005...

The Department of Prime Minister and Cabinet subsequently advised the Prime Minister that the ARTC had taken the opportunity to undertake a strategic review of the east coast rail line upgrading priorities and had developed an overall \$1.3 billion East Coast Rail upgrade programme which incorporated the use of the \$450 million special grant funds.

**3.31** As a result of this process, as of June 2007, of the \$450 million originally proposed and approved as a grant for rail re-alignments on the North NSW Coast line:

- \$289.5 million is to be used for construction of passing lanes between Melbourne and Junee;
- \$144.0 million involves a North Coast program of loop extensions and upgrades, bridgeworks, resilient fastening and weld straightening, level crossing upgrades and control system improvements; and
- \$16.5 million involves the introduction of centralised train control between Casino and Acacia Ridge.

**3.32** Significantly, none of the funds are being used to undertake rail re-alignments on the North NSW Coast line.<sup>63</sup>

## Payment of special grants

**3.33** The \$820 million in special grants has been paid to the ARTC as three separate, 'one-off' payments at the end of three consecutive financial years, as follows:

- \$450 million paid on 29 June 2004;
- \$100 million paid on 30 June 2005; and
- \$270 million paid on 27 June 2006.

<sup>63</sup> In its advice to DOTARS and Finance on 26 May 2005 regarding the finalised program of works to be undertaken with the first (\$450 million) special grant, the ARTC indicated that a program of passing lanes was to be undertaken in place of the initially proposed track deviations as there were a number of strategic advantages with passing lanes, including shorter construction times and substantially lower cost risks.

**3.34** All of the first and third special grants (of \$450 million and \$270 million) and \$42.8 million of the second special grant (of \$100 million) was paid from DOTARS' administered annual appropriations in the relevant financial year. The remaining \$57.2 million of the second special grant was paid from the Advance to the Finance Minister (AFM).<sup>64</sup>

## **Use of the Advance to the Finance Minister**

**3.35** The AFM is a provision authorised by the annual appropriations Acts to provide the Finance Minister with a central contingency fund. The Appropriation Acts provide that the AFM may only be accessed where:

- there is an urgent need for expenditure that is not provided for, or is insufficiently provided for, in the schedule to the Acts; and
- the additional expenditure is not provided for, or is insufficiently provided for, in the schedule to the Acts:
  - because of an erroneous omission or understatement; or
  - because the additional expenditure was unforeseen until after the last day on which it was practicable to provide for it in the Bill for the Act before that Bill was introduced into the House of Representatives.

**3.36** The Parliament has had a longstanding interest in the tests for accessing the AFM. For example, in a 1979 report titled *Advance to the Minister for Finance* the then Senate Standing Committee on Finance and Government Operations concluded that the existing criteria were too vague and subjective, as follows:<sup>65</sup>

We have considered the issue in the light of the basic principle that the Parliament should be given the maximum opportunity to appropriate moneys before they are drawn down from the public purse, consistent with the Government possessing the necessary degree of flexibility over expenditure. We have therefore concluded that access to the Advance for these purposes should only be given in "urgent unforeseen" circumstances.

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<sup>64</sup> In his June 2005 advice to the then Minister for Finance and Administration that he had approved a \$100 million grant to the ARTC, the then Prime Minister stated that the payment should only proceed if there were sufficient funds in the AFM and the payment could be made in 2004–05.

<sup>65</sup> Report from the Senate Standing Committee on Finance and Government Operations, *Advance to the Minister for Finance*, August 1979, Canberra, pp. 24–25.

**3.37** In terms of when AFM funding will be provided, Finance advice is that:<sup>66</sup>

AFM will only be issued if it is the last available source of funding. A decision of government or the Prime Minister is not a sufficient basis for approving an AFM.

**3.38** However, in terms of the urgency criterion, DOTARS' application to Finance for funds from the AFM for the second special grant stated that:

The Government has decided to provide a one-off grant to the Australian Rail Track Corporation of \$100 million in 2004–05. DOTARS has insufficient remaining appropriation to make this payment and it therefore has an urgent need for cash to make up the deficit.

**3.39** The five year timeframe in which the ARTC had advised DOTARS and Finance that the construction program for the first special grant would be undertaken reflects that the ARTC did not have an urgent need to receive \$100 million in additional cash prior to 30 June 2005. Also in this respect, in its 2004–05 Annual Report, the ARTC stated that:<sup>67</sup>

With special grants of \$450 million and \$100 million made available from the Australian Government and the previously announced \$550 million AusLink funding for rail projects, ARTC took the opportunity during 2004/05 to undertake a comprehensive review of its forward investment program. To optimise its investment options, draft strategies were prepared for the North South corridor and the Hunter Valley, which take into account revised business forecasts and industry consultations.

Following the release of these strategies, an industry forum was held in June 2005 seeking prospective alliance partners to undertake the six major packages of works that will form the basis of the \$1.4 billion (excluding AusLink funds) upgrading program over the next five years.

**3.40** Accordingly, there was no urgent requirement for payments to be made to the ARTC. Rather, the urgency arose from the focus on reducing the underlying Budget cash balance. In respect of the use of the AFM for the facilitation of payment of the \$100 million grant to the ARTC, in October 2007 Finance advised ANAO that:

Finance's guidance that a Government/Prime Ministerial decision in itself does not give rise to an AFM is correct. However, this statement should be read in

<sup>66</sup> Finance website, <[www.finance.gov.au/budgetgroup/afm\\_advance\\_to\\_the\\_finance\\_mi.html](http://www.finance.gov.au/budgetgroup/afm_advance_to_the_finance_mi.html)>, [accessed on 23 August 2007].

<sup>67</sup> ARTC Annual Report 2004–05, p. 2.

the context that the Finance Minister or his delegate must ensure that all applications, including government decisions, satisfy AFM criteria outlined in the appropriation acts. This requires that there is an urgent need for expenditure in the current year that is not provided for, or is insufficiently provided for in the appropriation acts, due to either an erroneous omission or understatement or because the expenditure was unforeseen. It should be noted that the financial position of the intended recipient of the payment does not have to be considered by the agency seeking the AFM when the Government has decided its policy on that issue. It is the availability of an agency's appropriation to make the payment that plays a significant role in dictating if an AFM would be sought.

The decision that DOTARS would provide an additional payment to ARTC is considered unforeseen as it was made subsequent to the finalisation of the bills. As stated in Finance's guidance: "Where expenditure has been excluded from an appropriation bill because it lacked the necessary final authority, and that formal authority was subsequently conferred, an AFM is available provided the urgency criterion was made". Formal authority includes a Government decision.

The expenditure was considered urgent, as the Government had announced its intention to make the payment before the end of the financial year and DOTARS had insufficient funding under the relevant appropriation acts to facilitate the transaction. Finance's guidance states that a typical situation that meets the urgency test is where a competent authority (the Government) has decided that a payment be made, the presumption should be made that the payment be made as soon as practical unless the contrary intention applies. The payment from DOTARS to ARTC clearly demonstrates this situation.

**3.41** The logical consequence of Finance's advice in this context is that the AFM is available to be used if any government were to decide for budgetary reasons that a payment should be made urgently prior to the end of a financial year. However, ANAO notes that, in its 289<sup>th</sup> report, the then Joint Committee of Public Accounts (JCPA) raised concerns that the Government might make a decision for funds from the AFM and by-pass the urgent and unforeseen criteria. In the context of the JCPA's inquiry, the then Department of Finance advised the Committee that it was rare for a Cabinet decision to specifically say that funds from the AFM would be provided but that, even if it did, the officer approving the advance on behalf of the Minister would turn their mind

to be satisfied that it was urgent and unforeseen.<sup>68</sup> Legal advice provided to the JCPA was that:<sup>69</sup>

The relevant provision commits to the Minister, and to no one else,<sup>70</sup> the power to form an opinion that particular expenditure meets the requirements [*of being urgent and unforeseen*]. It is a power expressed in subjective terms. However, the Minister is not free to form any opinion he pleases. His opinion must not be unreasonable and it must be formed having regard to the relevant considerations – including the correct legal meaning of the expressions ‘urgently required’<sup>71</sup> and ‘unforeseen’ and for permissible purposes.

**3.42** In this context, it is not without doubt that the payment of \$57 203 030 from the AFM to facilitate the payment of the \$100 million special grant to the ARTC was made in accordance with the legislated requirements for accessing the AFM. In this light there would be benefit in Finance reviewing guidance on the use of the AFM, particularly in relation to the ‘urgency’ criterion. Although not agreeing with ANAO’s view about the use of the AFM in this instance, Finance advised ANAO that it supported ANAO’s view that there would be benefit in it reviewing guidance on the use of the AFM and that the review will focus on simplifying the guidance and removing any ambiguity that may exist on the criteria for issuing an AFM, especially the ‘urgency’ criterion.

## Advance payments

**3.43** A number of ANAO performance audit reports have identified the cost and risk to the Commonwealth of accelerating expenditure so as to spend appropriated funds. For example, Audit Report No.37 1999–2000, *Defence Estate Project Delivery* stated:

Acceleration of expenditure to ensure that appropriations are spent may meet the perceived needs of Defence<sup>72</sup> but is to the disadvantage of the

<sup>68</sup> Report 289, *Advance to the Finance Minister*, Joint Committee of Public Accounts, Canberra, 1988, p. 11.

<sup>69</sup> *ibid*, p. 36.

<sup>70</sup> At the time of audit, the then Finance Minister had authorised officials within the Department of Finance and Administration to issue funds from the AFM for and on his behalf. Source: <[www.finance.gov.au/budgetgroup/afm\\_\\_advance\\_to\\_the\\_finance\\_mi.html](http://www.finance.gov.au/budgetgroup/afm__advance_to_the_finance_mi.html)>, [accessed on 23 August 2007].

<sup>71</sup> At the time of the JCPA’s inquiry, the appropriation bills referred to a requirement that the Finance Minister be satisfied that the expenditure was ‘urgently required’.

<sup>72</sup> ANAO Audit Report No.40 of 2005–06 noted (at p.75) that the Department of Defence’s procedures now require that prepayments only be made where the benefits outweigh the costs and associated risks. In addition, in that department, officials are required to ensure that appropriate processes are in place to properly identify and record a prepayment, and that risk identification and mitigation strategies are in place.

Commonwealth and the taxpayer. Accelerated expenditure has an opportunity cost equivalent to the Commonwealth's marginal cost of capital and should not be considered unless it has an equivalent benefit to the Commonwealth.<sup>73</sup>

**3.44** More recently, in Audit Report No.14 2007–2008 *The Regional Partnerships Programme*, ANAO concluded that:

If the Government considers it important that the department take further steps to spend the annual budgeted allocation, rather than the department making payments in advance of project requirements as has previously occurred, DOTARS should seek to improve its information on Programme funding needs by obtaining better information on the forward funding expectations for each project from applicants during the project assessment stage and, where funding is approved, updating this information as part of its project monitoring activities. Such an approach would provide more scope to fund additional applications under the Programme consistent with budget allocations.<sup>74</sup>

**3.45** Accordingly, as is advised in the ANAO *Administration of Grants* Better Practice Guide, in selecting funding strategies for a grants program, care should be taken to consider sound cash management principles (including those set out in ANAO's *Cash Management in the Commonwealth Public Sector* Better Practice Guide (1999)). In particular: <sup>75</sup>

large amounts should not be paid in advance because of the risk of non-performance of obligations, or non-compliance with the terms of a grant.

Where payments are made in advance there should be a net benefit in doing so. The net benefit could be demonstrated by:

- comparing the cost of administering payments in arrears to interest foregone;
- efficiencies for the recipient in either reducing the time to complete the project or funds required (possibly linked to reducing the amount of funding as these benefits are realised); or
- establishing that the funded activity would not proceed at all or in a timely fashion without payment in advance.

A comprehensive documented risk assessment and cost benefit analysis will assist in establishing that payment in advance of need was warranted or not.

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<sup>73</sup> ANAO Audit Report No.37 1999–2000, *Defence Estate Project Delivery*, Canberra, 4 April 2000, p. 50.

<sup>74</sup> ANAO Audit Report No.14 2007–2008, *The Regional Partnerships Programme*, Canberra, 15 November 2007, Volume 1—Summary and Recommendations, pp. 26–27.

<sup>75</sup> ANAO Better Practice Guide, *Administration of Grants*, Canberra, May 2002, pp. 31–32.

In general, performance reporting and monitoring regimes will be more rigorous for grants where payments are made in advance of progress.

**3.46** Similarly, Finance has issued a number of Finance Circulars over the years stating that early payment of public monies should only be considered where there is a financial benefit to the Australian Government.<sup>76</sup> The most recent of these, Finance Circular 2004/14, states as follows:

Efficient, effective and ethical management of Government resources includes making payments no earlier than necessary having regard to programme and service delivery objectives. As such, prepayments and early payments should only be made where there is a benefit to the Australian Government after taking all costs and risks into account.

If agencies pay suppliers or contractors earlier than required, the interest on the Australian Government's money held centrally with the Reserve Bank of Australia is reduced. Agencies should take this whole of government impact into consideration when assessing prepayments and early payments.<sup>77</sup>

### *Construction timeframes*

**3.47** It is well recognised that there are often substantial lead times involved in planning and delivering infrastructure construction projects.<sup>78</sup> In this respect, one option raised with Ministers in identifying measures to reduce the 2003–04 budget surplus was the possibility of making additional payments for major road construction projects. However, Finance recommended its Minister not support this option because the relevant legislation required payment to be linked to clearly defined projects and project milestones and any projects additional to those already budgeted were 'embryonic'.

**3.48** By way of comparison, due to the limited consultation by DOTARS with the ARTC (see paragraphs 3.4 to 3.6), advice to Ministers on the option of paying a special grant to the ARTC did not address the timeframe over which

<sup>76</sup> See Finance Circular 1995/3 *Cash Management: Timing of Payments Contractors and Traders, Lease Versus Buy*, Finance Circular 1997/09, *Payment of Accounts – Auditor-General's Report No.16 1996–97* and Finance Circular 2004/14 *Discounts for prepayment and early payment*.

<sup>77</sup> Department of Finance and Administration, Finance Circular No.2004/14, *Discounts for prepayment and early payment*, 29 September 2004, p. 1.

<sup>78</sup> See, for example, ANAO Audit Report No.45 2006–07 *The National Black Spot Programme*, Canberra, 19 June 2007, pp. 136–147 and ANAO Audit Report No.14 2007–2008, *The Regional Partnerships Programme*, Canberra, 15 November 2007, Volume 2—Main Report, pp. 615–627.

the ARTC was likely to spend the funds on rail infrastructure construction works.<sup>79</sup>

**3.49** Subsequent to being advised of the \$450 million special grant, the ARTC re-evaluated the overall program of works that had been contemplated prior to the announcement.<sup>80</sup> However, as a result of this review, actual construction works were not immediately commenced.<sup>81</sup> Accordingly, as illustrated by Table 3.1:

- no funds were spent in 2003–04 or 2004–05;
- as at 30 June 2006, only \$36 million of the special grants (4.4 per cent) had been spent;<sup>82</sup>
- as at 30 June 2007 (the most recent information held by DOTARS at the time of audit), less than 30 per cent of the total \$820 million in special grants had been spent; and
- the grants are not forecast to be fully spent until the 2008–09 financial year, five years after the first special grant was paid.

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<sup>79</sup> Subsequent analysis by DOTARS and Finance concerning the taxation effects of the payments to the ARTC sought to minimise any diminution in the cash available to the ARTC to spend on rail projects. However, this analysis was not comprehensive in that it did not address the additional benefits that would accrue to the ARTC by way of interest earned on the Australian Government funding, at a cost to the Australian Government.

<sup>80</sup> For example, the ARTC's 2004–05 Annual Report states (at page 2):  
*'With special grants of \$450 million and \$100 million made available from the Australian Government...ARTC took the opportunity during 2004/05 to undertake a comprehensive review of its forward investment program...'*

<sup>81</sup> In this respect, the ARTC's 2004–05 Annual Report states (at page 4):  
*'While an indicative scope of works was developed for the \$450 million Commonwealth grant, there was also a need to subject it to rigorous analysis, to optimise the scope of works in the context of available funding and an improved understanding of business needs'.*

<sup>82</sup> ANAO recognises that the \$270 million grant was paid on 27 June 2006 and, accordingly, little of this grant could reasonably have been expected to have been spent by 30 June 2006. Removing this grant from the equation results in expenditure by the ARTC of 6.5 per cent of the other \$550 million in special grants paid since June 2004.



**Table 3.1****Actual and forecast expenditure of special grants**

	2003–04 (\$m)	2004–05 (\$m)	2005–06 (\$m)	2006–07 (\$m)	2007–08 (\$m)	2008–09 (\$m)	Total (\$m)
<b>June 2004 funding (\$450 million)</b>	0.0	0.0	34.2	107.9	307.9	0.0	<b>450.0</b>
<b>June 2005 funding (\$100 million)</b>	0.0	0.0	1.8	67.0	26.2	5.0	<b>100.0</b>
<b>June 2006 funding (\$270 million)</b>	0.0	0.0	0.0	26.2	192.2	51.6	<b>270.0</b>
<b>Totals</b>	<b>0.0</b>	<b>0.0</b>	<b>36.0</b>	<b>201.1</b>	<b>526.3</b>	<b>56.6</b>	<b>820.0</b>

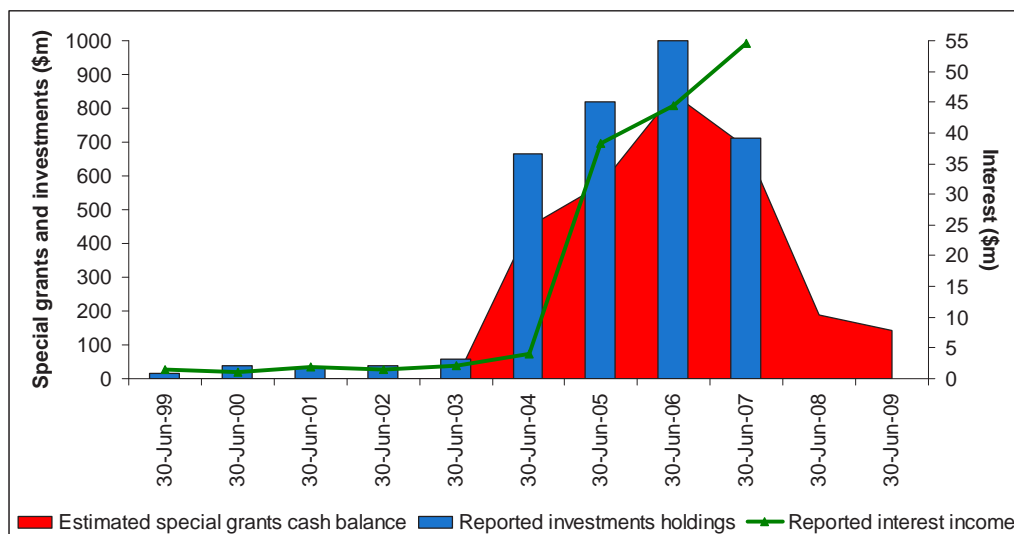
Note: The most recent information provided to DOTARS by the ARTC available at the time of audit was updated as at 30 June 2007. As a result, actual expenditure amounts known to DOTARS are those to 30 June 2007. For 2007–08 and 2008–09, the amounts are those forecast to be spent by the ARTC, as at 30 June 2007.

Source: ANAO analysis of DOTARS records.

**3.50** As illustrated by Figure 3.4, the payment of the special grants to the ARTC led to a significant increase in the ARTC's cash holdings. In addition, due to the timeframes involved in planning, designing and implementing projects to use the special grant funding, there has been a commensurate increase in ARTC's reported interest earnings on its investments.

**Figure 3.4**

**Special grant funding, ARTC investment holdings and interest income**



Source: ANAO analysis of DOTARS records and ARTC Annual Reports

**3.51** Based on the available information held by DOTARS concerning expenditure of the special grants, ANAO estimates that by 30 June 2009, when the ARTC advised DOTARS it expects to have spent the full \$820 million, the advance payments will have cost the Australian Government at least \$141.48 million in foregone interest earnings.<sup>83</sup> The composition of this amount is outlined in Table 3.2.

**Table 3.2**

**Potential interest earnings forgone by the Australian Government**

	Potential interest earnings forgone (\$)
Actual (to 30/6/07)	102 930 069
Forecast (2007–08, 2008–09)	38 555 385
<b>Total</b>	<b>141 485 454</b>

Source: ANAO analysis

<sup>83</sup> ANAO estimated the cost to the Australian Government of the advance payments using the Reserve Bank of Australia cash rate (as specified in Finance Circular 2004/14). A similar methodology was adopted in Audit Report No.31 2005–06 *Roads to Recovery* (see Appendix 3 to that report at pp. 194–195).

**3.52** The discretion afforded to the ARTC as to how it may choose to apply the \$820 million in special grant funding in order that the funds not be subject to taxation means that there is also no requirement for the ARTC to spend the interest earned on the special grants on rail infrastructure projects. By way of comparison:

- the funding conditions for the AusLink Roads to Recovery Program require that, if a funding recipient receives an amount as interest in respect of a payment under the program in one financial year, the funding recipient must spend an amount equal to the amount of interest on the construction or maintenance of roads in the next financial year and must be able to demonstrate that it has done so; and
- the MoU's with the relevant States and Territories in respect of the additional funding for the National Network provided in the 2006–07 Budget require the funding recipients to hold the funds in such a way that the Australian Government funding, and any interest earned, is separately identifiable. The MoU's also require any interest earned to be spent on the approved works, or, with the Australian Government's agreement, on other works on the National Network.

**3.53** In respect of the interest earned on the special grants, DOTARS advised ANAO in October 2007 that:<sup>84</sup>

Ultimately, the application of interest earned on ARTC funds is a matter for the ARTC Board of Directors.

In the case of the interest earned by the ARTC on the special grant funds, the funds are being applied to extending the programme to which the ARTC is applying the special grants...interest earned on investments is expected to switch to interest paid on borrowings in the next few years.<sup>85</sup>

**3.54** Similarly, the ARTC advised ANAO in January 2008 that:

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<sup>84</sup> Similarly, in December 2007, Finance advised ANAO that:

'While acknowledging that this statement [*that there is no requirement for the ARTC to spend the interest earned on special grants on infrastructure projects*] is essentially correct, it should be borne in mind that the focus of the Objects and Powers of ARTC's Memorandum of Association is to provide and operate a rail network on commercially sound principles, incorporating the activities management, access, maintenance and construction, growth and operational efficiency. On this basis the resources of ARTC, including interest earned, are required to be utilised in achieving the objectives of the company.'

<sup>85</sup> ANAO sought DOTARS' advice in November 2007 as to the identity of the projects on which the interest earned on special grant funds was being applied by the ARTC, the cost of those projects and their timeframes. DITRD LG advised ANAO in January 2008 that: '*The ARTC has advised the Department as part of its formal reporting arrangements that it is reinvesting interest earned from the grants into works on the interstate rail network, including its major north-south rail corridor program*'.

ARTC's investment in the Corridor Improvement Works Program significantly exceeds the amount of the 'special grants' and as such is funded by a combination of the earnings from those pooled investments, combined with funds generated from general operations and accumulated reserves.

Accordingly, all interest earned from the 'special grants' is effectively being invested in the North-South Corridor improvement program.

## Recommendation No.1

**3.55** ANAO *recommends* that, in advising its Ministers on opportunities to accelerate spending on land transport infrastructure works, the Department of Infrastructure, Transport, Regional Development and Local Government:

- (a) appropriately qualify its advice so as to reflect the extent of investigations and analysis that has been undertaken;
- (b) identify the timeframe over which it is expected that Commonwealth funding will be required; and
- (c) propose that payments only be made in advance where there is a net benefit in doing so and subject to appropriate risk management arrangements being put in place.

### *Agency responses*

**3.56** Finance and DITRDLG agreed to the recommendation. In addition, Finance commented on the recommendation as follows:

This recommendation is supported. Finance considers that Ministers should receive appropriate briefings covering all aspects of the required subject to enable the Minister to reach a fully informed, balanced and considered decision.

## Accountability arrangements for special grants

### Performance reporting

**3.57** Effectiveness indicators, reported in an agency's annual report, demonstrate the extent to which outputs and/or administered items make positive contributions to specified outcomes. In this respect, an ANAO performance audit report titled *Performance Information in Portfolio Budget Statements* recommended that agencies review their performance information to ensure that effectiveness indicators focus on the agency's particular

contribution to a Government policy outcome.<sup>86</sup> In commenting on that audit report, DOTARS agreed with the recommendation.

**3.58** Similarly, ANAO Audit Report No.23 of 2006–07, *Application of the Outcomes and Outputs Framework*, recommended that agencies review and, where necessary, improve their performance indicators to ensure that they have a range of appropriate indicators that incorporate better practice characteristics that provide stakeholders with useful and reliable performance information. The audit report outlined a number of better practice characteristics for performance indicators, namely that indicators should be: specific; measurable; achievable; relevant; and timed. Better practice performance indicators should also have benchmarks, and targets should be set.<sup>87</sup> Targets provide a basis for performance assessment and, from an accountability perspective, help Parliament to assess if a program and the administering agency are delivering to expectations. Targets can also encourage agency performance. In this respect:

Targets express quantifiable performance levels or changes of level to be attained at a future date, as opposed to the minimum level of performance. They may be a range or an absolute number, but they should never be vague or unmeasurable. They should focus on factors that managers can influence and may relate to either the overall outcome or output performance or the factors that lead to success. It may be necessary to have multi year targets which address the achievement of intermediate outcomes leading to achieving overall outcomes in a specified number of years. However, targets should not become the focus of achievement in their own right at the expense of overall performance.<sup>88</sup>

**3.59** As illustrated by Table 3.3, performance indicators including a targeted reduction in transit time were established for both the first and third special grants. However, overall the use of the special grant funding by the ARTC has not been adequately addressed by DOTARS in its performance reporting. Specifically:

- the first and third special grants were reported as separate administered programs by the department in the Annual Report

<sup>86</sup> ANAO Audit Report No.18 2001–02, *Performance Information in Portfolio Budget Statements*, Canberra, 1 November 2001, p. 50, Recommendation No.1.

<sup>87</sup> ANAO Audit Report No.23 2006–07, *Application of the Outcomes and Outputs Framework*, Canberra, 6 February 2007, p. 57.

<sup>88</sup> ANAO Audit Report No.18 2001–02, *Performance Information in Portfolio Budget Statements*, Canberra, 1 November 2001, p. 51.

relating to the year in which the funds were paid to the ARTC. There has been no performance reporting in respect to the second special grant;

- in its 2003–04 Annual Report DOTARS indicated that a three hour reduction in transit time between Sydney and Brisbane through the \$450 million first special grant had been ‘fully achieved’, although none of the funds had yet been spent by the ARTC on rail infrastructure improvements. There has been no performance reporting in respect to this special grant, or the progress in achievement of the target set for the grant, in either the 2004–05, 2005–06 or 2006–07 Annual Reports;
- in its 2005–06 Annual Report, DOTARS reported that the third special grant had ‘fully achieved’ its intended performance of assisting to reduce travel times for freight trains by between two and nine hours, although the ARTC had also not yet spent any of these funds, which had been paid on 27 June 2006. There was no performance reporting in respect of this special grant in the 2006–07 Annual Report.

**Table 3.3****Reporting of administered programs**

Annual Report year	Description	Performance Indicators	Cost (\$m)	Actual performance
2003–04	This one-off grant will enable the ARTC to invest in rail infrastructure including rail re-alignments on parts of the NSW north coast line to Brisbane.	Reduction in transit time between Sydney and Brisbane by at least three hours.	450.0	Fully achieved. <sup>A</sup>
2004–05	None provided.	None provided.	100.0	Not reported.
2005–06	Complete the replacement of old timber sleepers with concrete ones on the mainline track between Melbourne and the Queensland-New South Wales border.	Together with other works, this will reduce travel times for freight trains by between two and nine hours over the main rail corridor between Melbourne and Brisbane.	270.0	Fully achieved. <sup>B</sup>
<p>Notes:</p> <p><sup>A</sup> DITRDLG advised ANAO in January 2008 that: ‘Indicators referring to transit times were clearly related to the completion of the ARTC’s work programme and will be measured in that context. It would be inaccurate to imply that the actual performance column in the Department’s annual reports reflected these transit time indicators being “fully achieved” at the time when the capital works themselves had only just been proposed and therefore had not commenced. The expression “fully achieved” in relation to the untied grants as shown in the Department’s annual reports referred to the Department’s performance in paying the funds to the ARTC before the end of the financial year as requested by the then Government.’</p> <p><sup>B</sup> Reported as part of departmental performance as to whether ‘the Australian Government’s National Land Transport Plan (AusLink) is implemented to maintain and improve the standard of national infrastructure.’</p>				

Source: ANAO analysis of DOTARS Annual Reports 2003–04 to 2005–06.

**Reporting on the use of special grants**

**3.60** The ANAO *Administration of Grants* Better Practice Guide states that:

The evaluation of individual grants is best achieved through robust performance management supported by a sound monitoring regime. Performance information, specified in funding agreements, should enable an assessment of the effectiveness, efficiency and appropriateness of the individual grant throughout the life of the grant. Monitoring throughout the life of the project should focus, to the extent possible, on the contribution to overall program objectives as well as the achievement of project specific goals. On the completion or termination of a grant it should be evaluated in terms of the project specific and program related objectives.<sup>89</sup>

<sup>89</sup> ANAO *Administration of Grants* Better Practice Guide, May 2002, pp. 63–64.

**3.61** However, as noted, there is no funding agreement in place with the ARTC in relation to the special grants.

**3.62** In seeking to achieve a tax-free status for the special grants, the ARTC advised DOTARS that it was essential that the grants be made with no conditions attached (see paragraph 3.13). However, this advice did not prevent DOTARS from seeking the ARTC's agreement to a reporting and acquittal framework for the expenditure of funds on whatever projects were ultimately chosen by the ARTC, in the timeframe proposed by the company.

**3.63** Notwithstanding this option being open to DOTARS, there has been no formalised reporting regime established by DOTARS in respect of the ARTC's use of the special grants. Up until late 2006, the ARTC did not report to shareholder departments specifically on the use of the \$820 million in special grant funding.<sup>90</sup> In September 2006, the ARTC provided DOTARS with a one-page report giving a broad outline of the areas in which each of the special grants were being spent, the amounts that had been spent using each of the grants up to 30 June 2006, and the amounts expected to be spent from each of the grants in the forward years to 2008–09. This report is shown in Figure 3.5.

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<sup>90</sup> Prior to this time, the ARTC reported to shareholder departments on its overall capital works program, but the works being undertaken using the special grant funding were not separately identified in that reporting.



Figure 3.5

## ARTC's expenditure of special grants – September 2006 report

## ARTC - Government Grant Funding Received

	Spent to 30/06/2006	06/07 \$m	07/08 \$m	08/09 \$m	09/10 \$m	Total \$m
<b>June 2004 Funding (\$450m) (1)</b>						
Casino - Acacia Ridge Centralised						
Train Control	0.2	15.8	-	-	-	16.0
North Coast Program	8.7	56.2	68.3	10.7	-	143.9
Main South Program	25.3	172.2	92.6	-	-	290.1
	<b>34.2</b>	<b>244.2</b>	<b>160.9</b>	<b>10.7</b>	<b>-</b>	<b>450.0</b>
<b>June 2005 Funding (\$100m)</b>						
Brooklyn-Sunshine Triangle	0.1	10.7	4.2	-	-	15.0
Gauge Clearance (2)	1.0	-	1.0	-	-	2.0
Passing Lanes - Main South (3)	-	38.0	-	-	-	38.0
Concrete Resleepering (4)	-	44.0	-	-	-	44.0
Ardglen Tunnel	0.7	0.3	-	-	-	1.0
	<b>1.8</b>	<b>93.0</b>	<b>5.2</b>	<b>-</b>	<b>-</b>	<b>100.0</b>
<b>June 2006 Funding (\$270m)</b>						
Concrete Resleepering (4)	-	50.0	93.0	107.0	20.0	270.0

(1) The Commonwealth provided ARTC with a special grant of \$450 million in June 2005. ARTC advised an indicative program at that time that for expenditure to improve the North-South corridor, primarily in the corridor north of Sydney, including Sandgate; Bridge remediation, Loops, Lower Hunter Valley mains and signalling. A subsequent review of the program saw a shift in emphasis to allow increased focus on the Main South Line.

The most recent review of the North Coast program (excluding concrete resleepering) results in estimated total expenditure of \$ 143.9 million focussed on Crossing Loop extensions and upgrades (\$110+ M) Bridgeworks (\$13M); Resilient fastening & Weld straightening (\$8M); and other programs including Level Crossing upgrades and North Coast Control system improvements.

The principal utilisation of the balance of the \$450M grant funding in the South will be towards the cost of the major Passing Lanes program, which exceeds \$260 Million in total.

(2) The Original plan for expenditure of \$100 million, included \$40 million for improved Gauge Clearance however this was reviewed due to the impact of the concrete resleepering program. With the exception of \$2 million set aside for the Gauge Clearance study itself, it was seen as more appropriate to use the remaining \$38 million in funds towards the construction of the passing lanes on the Main South line as mentioned above.

(3) The total budget for passing lanes on the Main South line is \$261.7m. These works are scheduled for completion during 08/09. The \$38m allocated from the \$100m grant will be used to fund the initial projects which are scheduled to begin in 06/07.

(4) The total concrete resleepering program across the North-South Corridor is \$400 million, which ARTC will be funding partly from general reserves in addition to the allocation from June 2005 and the \$270 Million received in June 2006.

Source: DOTARS records.

**3.64** At the quarterly shareholder meeting held on 9 March 2007, the ARTC provided DOTARS and Finance with a summary of the ARTC's major works program. However, this report did not specifically report on, or identify, the components of the major works program that were being undertaken using the special grants. DOTARS' records indicate that the ARTC undertook to provide an updated cashflow for the special grants following the meeting. In this respect, on 29 March 2007, DOTARS received a two-page document from the ARTC, updating the report on the special grants that was provided in September 2006. This report provided an update of the expected spending

profile of each of the three special grants, and some additional detail in terms of the commencement and progress of works being funded by the grants.

**3.65** The reports provided by the ARTC in September 2006 and March 2007 on the use of the special grants were primarily expressed in terms of a program of works being undertaken, rather than identifying specific projects being funded. Subsequently, at the quarterly shareholder meeting held on 10 May 2007, the ARTC provided DOTARS and Finance with a document providing an updated breakdown of the expenditure to date and forecast expenditure profile for each of the special grants, as at 31 March 2007. The document also included some brief justification where it had been decided to substitute projects initially identified by the ARTC.<sup>91</sup> A further updated document was provided to DOTARS and Finance by the ARTC in August 2007, with expenditure incurred and forecast as at 30 June 2007.

**3.66** In respect of its reporting to shareholders on the use of the special grants, the ARTC advised ANAO in October 2007 that:

ARTC sees no conflict between its ability to provide ongoing reporting of its overall work program and the inclusion of information in relation to special grants as a by-product of that process...

ARTC has no objection with providing appropriate information to its shareholder representatives in relation to the investment program in the context of periodic reporting to shareholder representatives. It should be noted however that if this reporting is seen to be in the context of any specific conditions applicable to the monies provided (which ARTC contends was not the case) then this may have adverse income tax consequences.

## Grant acquittals

**3.67** 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. Adequate and well-documented arrangements to enable financial accountability are the basis of effective grant acquittal. In particular, reliable, timely and adequate evidence is required to demonstrate that grant funds have been expended in accordance with the terms and conditions of the grant agreement.<sup>92</sup>

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<sup>91</sup> In late March 2007, Finance, after consultation with DOTARS, had requested that the ARTC provide information relating to the current projects being undertaken by the ARTC with the special grants and advice as to which projects had changed from the original indicative program of works for each grant.

<sup>92</sup> ANAO Better Practice Guide, *Administration of Grants*, May 2002, p. 61.

**3.68** In respect of the first special grant, in May 2004, DOTARS advised the Senate Rural and Regional Affairs and Transport Committee that the ARTC would be required to acquit the \$450 million grant and that there was a process to ensure the funds would be used for their intended purpose. However, there is no formal framework in place for the ARTC to acquit the special grants and the interest earned thereon (see paragraph 3.53).

## Recommendation No.2

**3.69** ANAO *recommends* that, for any future projects funded other than through the land transport legislated funding framework, the Department of Infrastructure, Transport, Regional Development and Local Government formalise reporting and acquittal arrangements prior to the payment of funds.

### *Agency responses*

**3.70** Finance and DITRD LG agreed to the recommendation. In addition, Finance commented on the recommendation as follows:

This recommendation is supported. The Australian Rail Track Corporation, a 100 per cent Government owned entity, reports to shareholder departments quarterly providing a detailed breakdown of its Capital Infrastructure Programme which includes the progress of works and the expenditure of funds provided as Special Grants.

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Ian McPhee  
Auditor-General

Canberra ACT  
14 February 2008



# Appendices



## Appendix 1: Detailed DITRD LG Comments on the Proposed Report

The Department of Infrastructure, Transport, Regional Development and Local Government welcomes the ANAO's findings that the administration and arrangements covering the eight rail grants administered under the *AusLink (National Land Transport) Act 2005* at a total cost of \$155.3 million have been effective.

In addition to its role as a rail access provider as identified by the audit, the ARTC is responsible for infrastructure management and investment on the interstate network on behalf of the Government. This is set out in the 1997 inter-governmental agreement which led to the ARTC's establishment.

The Department notes that quarterly reporting arrangements between the ARTC and the Department have been in place since 2006 and the quality and detail of the reporting by the ARTC on its major works program as a whole, not just that covering grants by the Australian Government, has been continuously improved. In relation to reporting arrangements specifically related to the untied grants paid by the Government at the conclusion of the 2003–04, 2004–05 and 2005–06 financial years, the Department accepts there was a delay in establishing formal arrangements with the ARTC.

The Department notes that, for the first of the three untied grants provided by the Government to the ARTC (\$450 million, paid to ARTC on 29 June 2004), the initial urgent advice requested by the Government reflected limited consultation with ARTC on the scope for possible projects for which funds could be used, should they become available, on the north-south rail corridor. This reflected the Government timetable to which the Department was requested to respond and at that stage suggested that funding should be made available for works on the NSW north coast. The ARTC subsequently undertook a more detailed advice analysis of the corridor which led to the provision of funding to projects between Sydney and Melbourne as well as the NSW north coast.

The ARTC would not have obtained the full value of infrastructure works without provision being made for tax implications of the initial proposed grant to the ARTC. In addition, the provision of funding from untied grants also provided the ARTC with equivalent taxation status as comparable rail payments made by the Commonwealth to the States under AusLink.

The ARTC has advised the Department as part of its formal reporting arrangements that it is reinvesting interest earned from the grants into works on the interstate rail network, including its major north-south rail corridor program.

The Department accepts the report's two recommendations.



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