The Auditor-General
Audit Report No.10 2008–09
Performance Audit

Administration of the Textile, Clothing and Footwear Post–2005 (SIP) Scheme

Department of Innovation, Industry, Science and Research

Australian National Audit Office

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Canberra ACT
2 December 2008

Dear Mr President
Dear Mr Speaker

The Australian National Audit Office has undertaken a performance audit in the Department of Innovation, Industry, Science and Research 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 the Textile, Clothing and Footwear Post–2005 (SIP) Scheme.*

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

Ian McPhee
Auditor-General

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

AUDITING FOR AUSTRALIA

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Abbreviations

ABR	Australian Business Register
ACIS	Automotive Competitiveness and Investment Scheme
ANAO	Australian National Audit Office
ASIC	Australian Securities and Investment Commission
CSM	Customer Service Manager
DEEWR	Department of Education, Employment and Workplace Relations
DIISR	Department of Innovation, Industry, Science and Research
DITRD&LG	Department of Infrastructure, Transport, Regional Development and Local Government
FTA	Free Trade Agreement
IPMS	Integrated Program Management System
KPI	Key Performance Indicator
R&D	Research and Development
SIP	Strategic Investment Program
TCF	Textile, Clothing and Footwear
WTO	World Trade Organisation

Glossary

Advance of a grant	Is defined by Part 5 of the Scheme. In general, it is a payment that can be received in the financial year, following a Program Year. It provides up to 50 per cent of an entity's eligible grant amount.
Claim	A claim for a grant, as submitted to the department.
Deferred grant eligibility amount	Is defined by subsection 6.21(1) of the Scheme. In general, if an entity has invested in eligible activities, but has not exceeded the $200 000 threshold for the Scheme, the eligible grant amount (adjusted by modulation) is set aside to a subsequent Program Year until the threshold is passed.
Grant	A payment to an entity under the Scheme.
Eligible TCF activity	Is defined by section 1.6 of the Scheme. In general, it is manufacturing and design activities carried out in Australia, as well as certain ancillary activities, such as warehousing and distribution.
Excess amount	If an entity has their entitlement capped by the five per cent sales cap, the excess eligible grant amount (adjusted by modulation) can be carried over to the next Program Year.
Determination	The process followed by the department to work out whether the entity is entitled to be paid a grant, together with any deferred grant eligibility amount.
Sales-cap	Calculated at five per cent of the total eligible revenue in the previous income year. Calculated at 15 per cent for eligible start-up investment amounts for entities that qualify as start-ups.
Fully unacquitted advance	An advance that is requested by the entity, and paid by the department, but which is not followed by a claim, as required under the Scheme. This leads to a debt being incurred by the entity.

Minister	The Minister for Innovation, Industry, Science and Research.
Modulation	The process followed by the department to ensure that grant eligibility amounts do not exceed the annual funding limit for the Scheme.
Program Year	For most entities, the Program Year corresponds to a standard financial year ending 30 June. For those entities that use a 12-month accounting period that does not end on 30 June, the Program Year corresponds to the applicable accounting period.
Self-assessment	In the context of the Scheme, self-assessment means that the entity submits a claim, which is accompanied by an independent auditor’s report; but the entity’s claim is not subject to a desk-based assessment by the department before a grant is paid.
The Act	The *Textile, Clothing and Footwear Strategic Investment Program Act 1999.*
The Department	The Department of Innovation, Industry, Science and Research.
The Scheme	The *Textile, Clothing and Footwear Post-2005 Strategic Investment Program Scheme 2005*, a disallowable instrument, made under sections 37C and 37ZB of the Act.
Total eligible revenue	Is defined by section 1.9 of the Scheme. In general, it is the revenue derived from sales of the entity’s eligible TCF products during the relevant period, except sales to New Zealand and excluding any GST, excise or sales tax, and any subsidy given during the period by the Commonwealth, or a State or Territory.

Summary and Recommendations

Summary

Introduction

1. The textile, clothing and footwear (TCF) industry in Australia covers a diverse range of products and incorporates all stages of production from the processing of raw materials to the supply of finished products.[1] The industry is made up of around 4500 entities, including large companies like Pacific Brands Clothing Pty Ltd, high-end fashion designers, and familiar brand names like R.M. Williams, Speedo and Driza-Bone.

2. In 2005–06, sales and services income for the industry was $9.2 billion, and the industry accounted for 2.6 per cent of the total manufacturing activity in Australia. Around 48 000 people are employed in the industry, the majority of whom are based in the capital cities, especially Melbourne and Sydney. There is also significant activity in regional centres such as Geelong, Bendigo, Wangaratta, Albury-Wodonga and Devonport.[2]

3. Over the past ten years, the TCF industry has undergone rationalisation and restructuring in the context of increased global competition, new technologies, changing consumer patterns and tariff reductions.

Government assistance for the TCF industry

4. Currently, the major form of Australian Government support for the TCF industry is a ten-year assistance package, which commenced on 1 July 2005. This package includes $747 million in budget-funded programs along with a five-year pause on tariff reductions effective from 2005. The package was designed to help TCF firms adjust to a lower tariff environment, and it follows on from the industry assistance package that was in place from 2000 to 2005. Further tariff cuts are scheduled in 2010 and 2015.

5. The major program within the current assistance package is the TCF Post-2005 Strategic Investment Program Scheme (the Scheme). This Scheme is the focus of this audit and follows on from the TCF Strategic Investment Program (SIP) Scheme, which ran from 2000–01 to 2004–05.

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[1] Examples of TCF manufacturing activities are provided in Figure 1..

[2] Productivity Commission 2008, *Modelling Economy-wide Effects of Future TCF Assistance*, Melbourne.

The TCF Post-2005 (SIP) Scheme

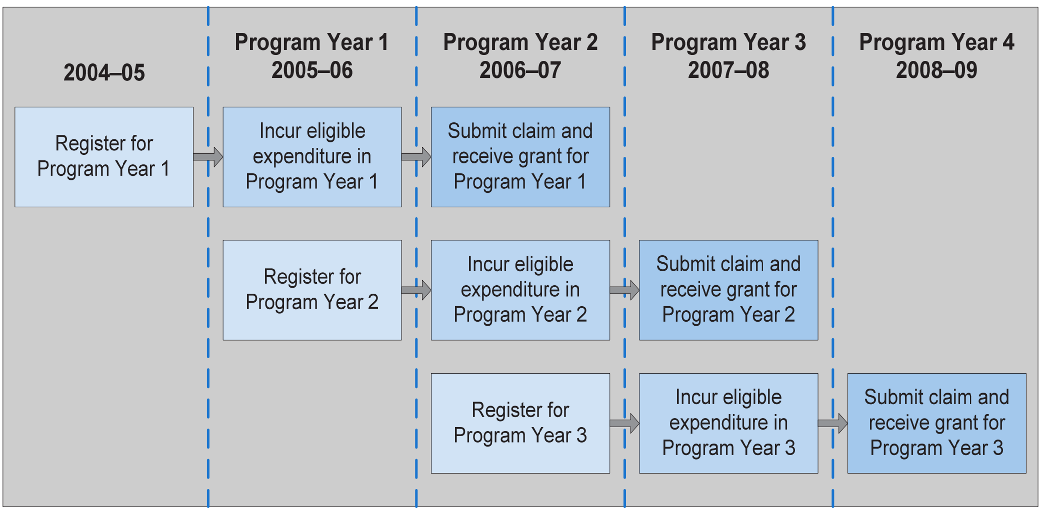
6. The statutory objective of the Scheme is to foster the development of a sustainable and internationally competitive TCF manufacturing industry and TCF design industry in Australia by providing incentives that will promote investment and innovation in the industry.[3] Grant funding of up to $575 million is available to eligible TCF entities across two five-year periods:

- up to $487.5 million to eligible TCF sectors from 2005–06 to 2009–10; and
- up to $87.5 million to the clothing and finished textiles sectors only from 2010–11 to 2014–15.

7. Each year of the Scheme is referred to as a 'Program Year', which for most entities corresponds to a standard financial year ending 30 June. To receive assistance, entities must register prior to the commencement of each Program Year, incur eligible expenditure in the Program Year, and then submit a claim to receive a grant payment in the financial year after each Program Year. This rolling, three-year cycle is illustrated in Figure 1.

Figure 1

Overview of the registration, expenditure and claim / payment cycle for the TCF Post-2005 (SIP) Scheme, for Program Year 1 to Program Year 3



Source: ANAO based on the *Textile, Clothing and Footwear Post-2005 Strategic Investment Program Scheme 2005*

[3] See section 37A of the *Textile, Clothing and Footwear Strategic Investment Program Act 1999.*

8. To register under the Scheme, an entity must show that it carries on or proposes to carry on an eligible TCF activity in Australia. These activities include: manufacturing of TCF products; design for manufacturing of TCF products; and certain ancillary activities such as warehousing and distribution. To qualify for support, entities must also spend more than $200 000 on eligible TCF activities during the relevant Program Year(s). Some 544 entities registered for the first year of the Scheme, 2005–06.

9. Entities that meet the eligibility requirements for the Scheme are able to access two types of grant payments—Type 1 grants provide up to 40 per cent of expenditure on eligible activities, while Type 2 grants provide up to 80 per cent of eligible expenditure. Table 1 lists the type of activities able to be claimed under these grants.

Table 1

Activities able to be claimed under the TCF Post-2005 (SIP) Scheme

Type 1 grants		Type 2 grants
Acquisition or construction of new TCF plant or equipment		Research and development
Acquisition or construction of new buildings or structures (or alterations) to house TCF plant or equipment as a consequence of acquiring new TCF plant or equipment		Innovative product design
Upgrading of existing TCF plant or equipment to meet environmental requirements		Innovative process improvement
Acquisition of new computer hardware or software, or development of new software		Market research
Participation in trade-showings and in-store promotions (brand support)		Obtaining industrial property rights
Non-production related information technology[4]		

Source: ANAO based on the *Textile, Clothing and Footwear Post-2005 Strategic Investment Program Scheme 2005*

10. After the end of each Program Year, entities can access scheme funds by lodging a claim for a grant payment, or by requesting an 'advance' of a grant payment (to be followed by a claim). Advances must not exceed 20 per cent of the eligible grant amount for Type 1 grants, or 40 per cent of the eligible grant amount for Type 2 grants. When claiming and receiving an advance or grant payment, entities must be undertaking an eligible TCF activity.

[4] This grant is available only to entities carrying on eligible clothing or finished textile activities.

11. Total grant payments are capped at $97.5 million per year for the period 2005–06 to 2009–10 and at $17.5 million per year for the period 2010–11 to 2014–15.[5] If the total claims for scheme funds exceed the annual funding limit (as happened in Program Years 1 and 2), all claims are reduced through a modulation process designed to ensure that the annual funding cap is not exceeded. Some funding limits also apply to individual grant payments.

12. For Program Year 1, a total of $96.1 million in grants were paid to 341 entities.[6] Payments ranged from a few hundred dollars to, in one case, over $6.4 million. However, the majority of grants were under $300 000.

Legislative and administrative framework

13. The Scheme was established under the *Textile, Clothing and Footwear Strategic Investment Program Act 1999* (the Act) and a disallowable instrument, the *Textile, Clothing and Footwear Post-2005 Strategic Investment Program Scheme 2005* (the Scheme). The Act and Scheme are administered by the Department of Innovation, Industry, Science and Research (DIISR).[7] AusIndustry, a service delivery division within DIISR, is responsible for the day-to-day administration of the Scheme. This includes: registering entities; assessing entities' advances and claims; paying grants and carrying out compliance and education activities. The Manufacturing division is responsible for the policy and legislative framework for the Scheme.

External reviews of the TCF industry

14. Since 2000, there have been two external reviews of government assistance to the TCF industry. The first was in 2002, during the previous TCF SIP Scheme, which was undertaken by the Productivity Commission[8]; and the second in 2008, which was led by Professor Roy Green. The Terms of Reference for the 2008 review include an examination of the appropriateness and effectiveness of assistance provided under the 2005–2015 package, including the Scheme. Professor Green's report, *Building Innovative Capability*, was publicly released by the Minister in September 2008.

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[5] For Program Years 2006–07 to 2009–10 and 2011–12 to 2014–15, annual funding limits may include unspent funds from previous years, plus any deferred grant eligibility amounts.

[6] A further $1.07 million in deferred grant eligibility amounts was set aside for subsequent Program Years.

[7] Prior to the change of government in November 2007, the Scheme was administered by the Department of Industry, Tourism and Resources.

[8] Productivity Commission 2003, *Review of TCF Assistance*, Report No. 26, Canberra.

Audit objective and scope

15. The objective of this audit was to assess whether the Scheme is being administered effectively by the department. The ANAO focussed on Program Year 1 of the Scheme, 2005–06, and examined DIISR's arrangements for:

- assessing the eligibility of entities to receive grants;
- assessing entities' claims for eligible expenditure;
- adhering to the funding limits for the Scheme when calculating and paying claims, and managing any debts that arise; and
- evaluating and reporting on whether the statutory objective of the Scheme is being met.

16. The audit did not examine the other components of the 2005–2015 industry assistance package; nor did it examine any of the programs delivered under the previous assistance package (2000–2005).

Overall conclusion

17. The Scheme is the Australian Government's main budget-funded program for the TCF industry, and is part of a broader industry assistance package worth $747 million. It provides up to $575 million in cash entitlements to eligible entities over the ten-year period until 2014–15, and follows on from the TCF SIP Scheme, which provided $641 million in benefits from 2000–01 to 2004–05. The aim of the Scheme is to foster the development of a sustainable and internationally competitive TCF industry in Australia.

18. Overall, the Scheme is being administered effectively by the department. There are sound processes and controls in place to assess the eligibility of entities to receive assistance and for calculating and paying grants within the funding limits of the Scheme. The department's approach to program management is responsive to the experience it has gained in administering this and other large industry assistance programs. Introducing self-assessment for selected entities will provide opportunities for DIISR to better target its program of site visits, as part of its claim assessment process. However, more broadly, the department is not in a position to assess by reference to key performance indicators whether the statutory objective of the Scheme is being met—the development of a sustainable and internationally competitive TCF industry in Australia.

19. In administering the Scheme, DIISR faces challenges in verifying expenditure claimed on innovation activities (a Type 2 grant). These activities made up nearly half of all claimed expenditure in 2005–06 and 2006–07, but they are not defined under the legislation, and are therefore open to interpretation by entities. Of the four main methods DIISR uses to assess claims, site visits provide the best means of gaining timely and first-hand assurance that claimed expenditure was valid and that eligibility requirements were met. However, for Program Year 1, most site visits were undertaken outside the peak claim assessment period (from February to May 2007), when the bulk of claims were lodged. This limited the usefulness of these site visits.

20. DIISR's decision to introduce the self-assessment of claims on selected entities for Program Year 2 (and potentially beyond) provides a means to take a more targeted and risk-based approach to claim assessment. There is scope for DIISR to extend the benefits of such an approach by enhancing aspects of its compliance management strategy; this includes refining its program of site visits to target higher-risk entities during the claim assessment stage, and providing additional feedback and guidance to entities on the types of claims that are not supported, to minimise the risk of future mis-claiming.

21. An external review of the TCF industry conducted in 2008 found that the current Scheme and the previous TCF SIP Scheme have made a positive contribution to Australia's TCF industries, helping entities to reposition themselves to compete in the changing business environment.[9] However, although the department collects a range of industry data, it has not developed the necessary key performance indicators to determine the impact of the Scheme on the TCF industry. To address this gap in its performance management framework, DIISR could develop and report against intermediate outcomes for the Scheme, as it does for the Automotive Competitiveness and Investment Scheme.

22. The ANAO made two recommendations aimed at improving DIISR's administration of the Scheme, which seek to enhance its compliance management strategy and its performance management framework.

Summary of DIISR's response

23. The department welcomes the ANAO's conclusion that the Scheme is being administered effectively, with sound processes and controls in place to

9 Green, R. 2008, *Building Innovative Capability: Review of the Australian Textile, Clothing and Footwear Industries*, Commonwealth of Australia, p. 62.

assess eligibility of entities to receive assistance and for calculating and paying grants within the funding limits of the Scheme. In addition, the ANAO has indicated that the current assessment process is well-documented and timely. The department notes the ANAO's confirmation that appropriate measures have been taken to reduce the risk of debts occurring following the first year of the Scheme. The department agrees to implement the ANAO's two recommendations.

Key findings by chapter

Eligibility for assistance (Chapter 2)

24. AusIndustry is responsible for assessing whether entities have met eligibility requirements before paying any grants under the Scheme. These requirements include:

- being registered before 1 July of the relevant Program Year;
- incurring more than $200 000 in eligible expenditure during the relevant Program Year(s)[10]; and
- undertaking an eligible TCF activity at the time of making a claim and receiving a payment in the financial year following each Program Year.

Registration of eligible entities

25. For Program Year 1, 544 entities had registered under the Scheme. The ANAO examined a sample of 40 files for entities that received a grant payment (around 10 per cent of grant recipients that year). All 40 entities had met key registration requirements. This included registering before the deadline of 1 July 2005, providing copies of their financial statements and a statement of strategic business intent, and estimates of expenditure on eligible activities for the next two Program Years. These estimates allow DIISR to gauge the demand for Scheme funds. Departmental staff followed standard processes when assessing applications for registration, as set out in a procedures manual.

Eligibility issues identified for Program Year 1

26. Based on its assessment of 374 claims received for Program Year 1, DIISR identified three separate instances where Scheme funds were provided to entities that were subsequently found to be ineligible for assistance. In brief, two of these cases involved entities that received an advance payment, but

[10] Entities who do not exceed this expenditure threshold are able to apply for grants of up to $50 000 under the TCF Small Business Program, which is also administered by DIISR.

then became ineligible to apply for a grant. The third case, which is before the Administrative Appeals Tribunal, involved problems surrounding the transfer of registration from one entity to another. The department paid out a total of $578 000 to these entities, which amounted to less than one per cent of total grant payments that year.

Undertaking eligible TCF activities

27. DIISR does not independently verify that entities are undertaking an eligible TCF activity at each discrete period during the claim and payment cycle (Figure 1). Instead, it requires entities to provide written declarations about their eligibility to receive assistance at each stage of the registration and claim process. It then seeks to confirm the veracity of these declarations, through the following mechanisms, either in the actual claim year or during the three-year cycle for each Program Year:

- desk-based assessment of all claims;
- site visits to selected entities' premises; and
- searches on the Australian Business Register website, and the Australian Securities and Investment Commission website to confirm the entity is a registered business, and to identify any changes in the entity's status, which could affect its eligibility to receive a grant.

28. The ANAO confirmed that these checks were undertaken for Program Year 1. However, most site visits were not undertaken during the actual claim assessment period, which reduced DIISR's ability to gain first-hand assurance that eligible TCF activities were being undertaken as claimed. Nevertheless, as discussed in Chapter 3, the department's decision to introduce the self-assessment of claims for selected entities for Program Year 2 (and potentially beyond) provides an opportunity to undertake additional site visits during the claim and payment periods, and to confirm the eligibility of entities to receive support.

Assessing entities' claims (Chapter 3)

29. As outlined in Table 1, entities that satisfy the eligibility requirements for the Scheme are able to claim two types of grants—Type 1 grants provide up to 40 per cent of expenditure on eligible activities, while Type 2 grants provide up to 80 per cent of eligible expenditure.

30. Applications for grants are to be made in the financial year after the Program Year in which eligible expenditure was incurred. To access Scheme funds, entities can either request an advance of a grant, to be followed by a claim; or by lodging a claim only. Advances must not exceed 20 per cent of the eligible grant amount for Type 1 grants, or 40 per cent of the eligible grant amount for Type 2 grants.

Claims for Program Year 1

31. For Program Year 1, DIISR received claims from 374 entities, with 245 of these also requesting an advance of a grant payment. The total amount of expenditure claimed by (but not paid to) entities was $271.2 million, almost half of which was for innovation activities, a Type 2 grant. A key challenge that DIISR faces in assessing claimed expenditure on innovation activities is that the Scheme does not define 'innovation'. Instead, it provides general criteria on activities that are considered not to be innovative. This approach requires entities and the department to exercise judgement in determining which activities qualify for support.

Claim assessment methods

32. For Program Year 1, DIISR elected to assess all requests for advances and all claims, rather than allowing entities to self-assess their claims, as permitted under the Scheme. This approach was consistent with its coverage of claims during the previous TCF SIP Scheme. The key assessment methods were:

- desk-based assessment of all claims, which were conducted by the customer service manager (CSM) assigned to each entity;
- review of auditor's reports, which entities are required to provide with their claim;
- site visits to selected entities' premises (110 visits, some 29 per cent of all claimants); and
- compliance appraisal visits for a smaller number of entities (15, some four per cent of all claimants), which are separate to CSM site visits, and aim to validate the work performed by auditors.

These claim assessment methods were part of a broader compliance management strategy AusIndustry has developed to manage the risks associated with its day-to-day administration of the Scheme.

33. The ANAO examined 40 claims, and all claims had been subject to a desk-based assessment by a CSM. All claims included an independent auditor's report, which attested that the revenue and expenditure amounts claimed by the entity had been substantiated, on a sample basis, by the auditor. However, most site visits, which provide a useful means of gaining first-hand assurance that activities were undertaken as claimed, took place outside the peak claim assessment. That is, most visits were undertaken from May to December 2006, before the bulk of claims were submitted in February 2007; or they were undertaken in June 2007, following the payment of grants for Program Year 1.

34. The main reason for site visits not being undertaken during the peak claim assessment period is because the department had to meet the 60-day processing deadline for the advances and claims. The decision to assess all claims, rather than allowing appropriate claims to be self-assessed limited the usefulness of site visits as a tool to verify the expenditure claimed by entities. This was particularly relevant for innovation activities, which are not easily substantiated through desk-based assessment and are not explicitly covered in the auditor's report.

Claim assessment for Program Year 2 and beyond

35. Of the 378 claims received for Program Year 2, self-assessment was allowed in 60 claims, or around 15 per cent of all claims lodged with the department. In determining which claims were suitable for self-assessment, the department developed a risk rating procedure, which seeks to identify those entities that present a higher risk of making non-compliant claims. In practice, self-assessment means that these claims were approved and paid as claimed, without being subject to a full desk-based assessment. However, all entities were still required to provide an independent auditor's report as part of their claim, and may have undergone a previous site visit.

36. Self-assessment allows the department to adopt a more risk-based approach to assessing claims. If implemented effectively, it will free up resources during the peak claim assessment period, allowing the department to focus these resources on assessing higher risk entities. There is scope for DIISR to extend the benefits of such an approach by enhancing aspects of its compliance management strategy. This includes refining its program of site visits, to target higher risk entities during the 60-day claim assessment stage, and providing additional feedback and guidance to entities on the types of claims that are not supported, to minimise the risk of future mis-claiming. Fact sheets and other guidance material also need to be regularly reviewed and updated.

Calculating grants and managing debts (Chapter 4)

37. DIISR determines the final grants to be paid to an entity after it takes into account:

- the amount of any advance provided;
- the requirement for grants not to exceed five per cent of an entity's total eligible revenue in the previous financial year; and
- the need to accommodate all grant payments within the annual funding limit for the Scheme ($97.5 million in Program Year 1).[11]

All grants must be paid by 10 June after the end of each Program Year.

Payment system

38. DIISR uses its Integrated Program Management System (IPMS) to calculate grant entitlements and to maintain the registration details of entities. Payments within IPMS are calculated using figures entered by CSMs during the assessment of claims.[12]

39. Prior to making grant payments for Program Year 1, DIISR took a number of additional measures to gain assurance that IPMS was robust and reliable. This included engaging an external contractor, who developed a parallel system to check the accuracy of payments made in IPMS. AusIndustry also developed its own parallel payment system to check the accuracy of payments. It then conducted a review of payments made for Program Year 1, and identified two errors, the net impact of which was negligible.

40. The ANAO reviewed the payment system within IPMS, both for Program Year 1 and in relation to new functionality for Program Year 2 (which mainly covered debt management). Overall, the ANAO confirmed that:

- appropriate IT change management procedures and quality assurance controls are in place to preserve the completeness, accuracy and reliability of Scheme data; and
- appropriate application controls are in place to ensure the correct calculation of payments, and that scheme funds are managed within legislative funding parameters.

[11] The full list of payment factors for the Scheme is provided in Appendix 4.

[12] These figures are checked to confirm that they match the amounts approved by the delegate.

Final payments

41. Grant payments for Program Year 1 were made in the period 31 May 2007 to 7 June 2007, prior to the payment deadline of 10 June 2007. A total of $96.1 million in cash entitlements were paid to 340 entities, and a further $1.07 million in deferred grant eligibility amounts was set aside for subsequent program years.[13] In calculating grants, the department modulated all payments by a factor of 0.73 to ensure the annual funding limit of $97.5 million was not breached. It also reduced the individual entitlement of 186 entities to adhere to the five per cent sales-capping rule.

Scheme debts and ongoing management

42. In Program Year 1, $1.51 million in scheme debts were identified, relating to 52 separate entities. Individual debts ranged from $201 to $219 000, but most debts were under $50 000. Some 50 debts resulted from entities receiving more in an advance payment than their final grant entitlement, when it was subsequently determined. As of 30 June 2008, all 50 entities that had received overpaid advances had repaid their debts. DIISR took a number of steps to minimise the risk of debts occurring in Program Year 2 and beyond. This included seeking legislative changes to the Scheme and implementing better processes for assessing advances. For Program Year 2, five debts were identified by the department, which totalled around $334 000, significantly less than for Program Year 1.

43. DIISR's decision to exclude advance-related debts from the modulation process meant that it had to find an additional source of funding for Program Year 1 (and potentially beyond). Approval was received to re-allocate $1.51 million from another program administered by the department. This situation has created some ongoing issues for DIISR to manage, including having to find similar funding arrangements on an ongoing basis.

Governance and effectiveness (Chapter 5)

44. The Scheme is one of many industry programs delivered by AusIndustry, and is subject to the same governance arrangements that apply to other programs delivered within the department. These arrangements cover: planning and risk management; policies and procedures; delegations and authorisations; internal reporting and executive oversight; and stakeholder

[13] If an entity has invested in eligible activities, but has not exceeded the $200 000 threshold, the eligible grant amount (adjusted by modulation) is set aside to a subsequent Program Year until the threshold is passed.

management. The ANAO confirmed that each of these elements was in place during the first year of the Scheme, and they continue to be part of DIISR's governance framework. However, for Program Year 1, there was a lack of agreement between the policy and program delivery teams on the appropriate basis for modulating grant payments. This matter took around eight months to resolve and put pressure on the development of the final payment system. The earlier escalation of this issue within DIISR would have assisted in more timely resolution of this matter.

Evaluating and reporting on the effectiveness of the Scheme

45. In 2008–09, DIISR included a specific performance indicator, and an associated performance target, to measure the increase in investment in plant and equipment and innovation. The target will give an appreciation of whether there has been an increase in investment over time. However, it does not measure whether this increase is a direct result of the Scheme, or whether the investment might have occurred in any case.

46. DIISR has relied on two external reviews of the TCF industry to comment on whether the Scheme and the previous TCF SIP Scheme have been beneficial for the industry and have achieved the desired policy outcomes.

External reviews of the TCF industry

47. The two external reviews of the TCF industry (in 2002 and 2008) have provided analysis, insights and recommendations to inform the Government's policy settings for the TCF industry. Professor Green's report, which was publicly released in September 2008[14], did not comment directly on whether the assistance provided under the current Scheme has assisted the industry to be more 'sustainable' and 'internationally competitive', in line with its statutory objective. However, it concluded that the current Scheme and the previous TCF SIP Scheme have made a positive contribution to Australia's TCF industries, helping entities to reposition themselves to compete in the changing business environment.[15]

48. Although the department collects a range of industry data, it has not developed the necessary key performance indicators to determine the impact of the Scheme on the TCF industry, and the longer-term policy objective of making the industry more sustainable and internationally competitive. To

[14] Green, R. 2008, *Building Innovative Capability: Review of the Australian Textile, Clothing and Footwear Industries*,, Commonwealth of Australia.

[15] ibid, p. 62.

enhance its performance management framework, the ANAO considers that DIISR could develop and report against intermediate outcomes for the Scheme, as it does for the Automotive Competitiveness and Investment Scheme.

Recommendations

Recommendation No. 1 **Para 3.38**	To enhance the compliance management strategy for the Textile, Clothing and Footwear Post-2005 (SIP) Scheme, the ANAO recommends that the Department of Innovation, Industry, Science and Research: (a) refine its program of site visits, to target higher-risk entities during the 60-day claim assessment period; (b) provide additional feedback to entities on the types of claims that are not supported, to minimise the risk of mis-claiming in the following Program Year(s); and (c) regularly review and, where necessary, update guidance material for scheme participants. **Department's response**: *Agreed*
Recommendation No. 2 **Para 5.22**	The ANAO recommends that the Department of Innovation, Industry, Science and Research enhance its performance management framework for the Textile, Clothing and Footwear Post-2005 (SIP) Scheme by: (a) developing intermediate outcomes for the Scheme and appropriate performance measures; and (b) reporting progress against these outcomes annually (or as reliable data becomes available). **Department's response:** *Agreed*

Audit Findings and Conclusions

1. Background and Context

This chapter provides an overview of the textile, clothing and footwear industry in Australia and outlines government assistance measures for the industry. The objective, scope and methodology of the audit are also outlined.

The Australian textile, clothing and footwear industry

1.1 The textile, clothing and footwear (TCF) industry in Australia covers a diverse range of products and incorporates all stages of production from the processing of raw materials to the supply of finished product, as illustrated in Figure 1.1.

Figure 1.1

Examples of TCF manufacturing activity

- Early stage processing — the preparation or production of leather and textile fibres:
  - leather production including activities such as salting, wet blueing (the first stage of tanning), finishing and fur dressing;
  - natural fibres — mainly cotton and wool, but also niche materials such as cashmere and alpaca;
  - man-made fibres: including cellulosics such as viscose; synthetics such as polyester, nylon, acrylic and polypropylene (all derived from petrochemicals); and
  - fibres made from inorganic materials such as glass, metal or ceramics
- Production of textiles, which involves the conversion of fibres into yarns and fabrics (through spinning, weaving, knitting, tufting etc)
- Finishing activities — aimed at giving fabrics visual, physical and aesthetic properties (through bleaching, printing, dyeing, impregnating, coating, plasticising etc)
- Transformation of yarns, fabrics and leather into products such as:
  - clothing and footwear (involving design, patternmaking, fabric cutting and assembly);
  - carpets (woven, knitted, tufted and flocked) and other textile floor coverings;
  - home and commercial textiles (including towels, bed linen, curtains); and
  - technical textiles, which encompass performance or functional characteristics (including shade cloth, medical products, insulation materials, geotextiles).

Source: Productivity Commission 2008, *Modelling Economy-wide Effects of Future TCF Assistance*, Box 1.1.

1.2 The industry is made up of around 4500 entities, including large companies like Pacific Brands Clothing Pty Ltd, high-end fashion designers, and familiar brand names like R.M. Williams, Speedo and Driza-Bone. There are also many small and medium sized privately-owned firms, especially in the clothing sector, that commonly rely on outworkers to assemble garments.

1.3 In 2005–06, sales and services income for the industry was $9.2 billion. In the same period, the industry accounted for 2.6 per cent of the total manufacturing activity in Australia, or just under 0.3 per cent of gross domestic product. Around 48 000 people are employed in the industry, the majority of whom are based in the capital cities, especially Melbourne and Sydney. There is also significant activity in regional centres such as Geelong, Bendigo, Wangaratta, Albury-Wodonga and Devonport.[16] Some 85 per cent of TCF entities employ between one and 20 people.

A textile manufacturing operation in Geelong, Victoria, which, among other things, produces the fabric for bullet-proof vests Photo: ANAO, courtesy of Melbatex Pty Ltd

1.4 Over the past ten years, the TCF industry has undergone rationalisation and restructuring in the context of increased global competition, new technologies, changing consumer patterns and tariff reductions. Table 1.1 provides some key industry statistics over this period, which show a reduction in employment, industry value added and exports.

[16] Productivity Commission 2008, *Modelling Economy-wide Effects of Future TCF Assistance,* Melbourne.

Table 1.1

TCF industry statistics for the period 1997 to 2007

TCF measure	1997	2002	2005	2006	2007	Average annual growth (over last 10 years)
Industry value added ($m)	5 910	4 502	2 937	3 044	2 781	-7.3%
Employment ('000s)	98.3	76.9	59.5	46.2	51.6	-6.2%
Exports ($m)	3 059	2 870	1 748	1 680	1 675	-5.8%
Imports ($m)	5 644	7 764	8 175	8 703	8 959	4.7%

Source: The Australian Bureau of Statistics, cited in the TCF Review Background Paper 2008

International context

1.5 Globally, the TCF industry is facing significant competition from manufacturing firms in China and other countries in South-East Asia, who have cost and scale advantages over many entities in Australia. International developments, such as bi-lateral and multi-lateral trade agreements, also have an impact on the industry. Australia is currently party to four free trade agreements (FTAs)—with the United States, Thailand, Singapore and New Zealand—and other FTAs are under negotiation. These agreements present opportunities for the Australian TCF industry by lowering tariffs on a range of TCF products in these export markets. FTAs have also lowered tariffs on TCF goods entering Australia, opening the industry up to increased competition.

1.6 Australia also has trade obligations through its membership with the World Trade Organisation (WTO). While industry assistance is generally permitted for member countries, the WTO *Agreement on Subsidies and Countervailing Measures* prohibits the use of subsidies if they are contingent, in law or in fact, upon export performance or upon the use of domestic over imported goods. The Australian Government is required to adhere to this requirement when formulating any assistance measures for the TCF industry.

Australian Government assistance

1.7 Like other manufacturing industries, the TCF industry has received various forms of assistance from successive governments. This assistance is provided through tariffs on imported products, which are designed to protect the industry from overseas competitors, and through budgetary measures such as grants, subsidies and tax concessions. Most State governments also provide support to the TCF industry through schemes such as innovation and regional development programs. The Productivity Commission reported in 2008 that the TCF industry was one of the most highly-assisted manufacturing industries in Australia, along with the automotive industry.[17]

Industry assistance packages—2000 to 2015

1.8 Currently, the major form of Australian Government support for the TCF industry is a ten-year assistance package, which commenced on 1 July 2005. This package includes $747 million in budget-funded programs along with a five-year pause on tariff reductions, effective from 2005. It was designed to help TCF firms adjust to a lower tariff environment, and it follows on from the industry assistance package that was in place from 2000 to 2005. The 2000–2005 package provided $641 million in grant assistance and import duty foregone to the industry.[18] Under the current ten-year assistance package, further tariff cuts on TCF products are scheduled in 2010 and 2015, as illustrated in Table 1.2.

Table 1.2

Current and scheduled tariffs on TCF products, 2005 to 2015

Category	2005 (%)	2010 (%)	2015 (%)
Clothing and finished textiles	17.5	10.0	5.0
Cotton sheeting and fabrics	10.0	5.0	5.0
Sleeping bags, table linen	7.5	5.0	5.0
Carpet	10.0	5.0	5.0
Footwear	10.0	5.0	5.0
Footwear parts	7.5	5.0	5.0
Other (for example, yarns)	5.0	5.0	5.0

Source: The Department of Innovation, Industry, Science and Research

1.9 The major program within the current (2005–2015) assistance package is the TCF Post-2005 Strategic Investment Program Scheme (the Scheme). This Scheme is the focus of this audit and follows on from the TCF Strategic Investment Program (SIP) Scheme, which ran from 2000–01 to 2004–05. The

[17] Productivity Commission 2008, *Trade & Assistance Review 2006–07*, Annual Report Series, Productivity Commission, Canberra, March.

[18] The foregone duty related to the Product Diversification Scheme, which is outlined in Appendix 2.

other budget-funded programs within the 2005–2015 assistance package are outlined in Appendix 2.

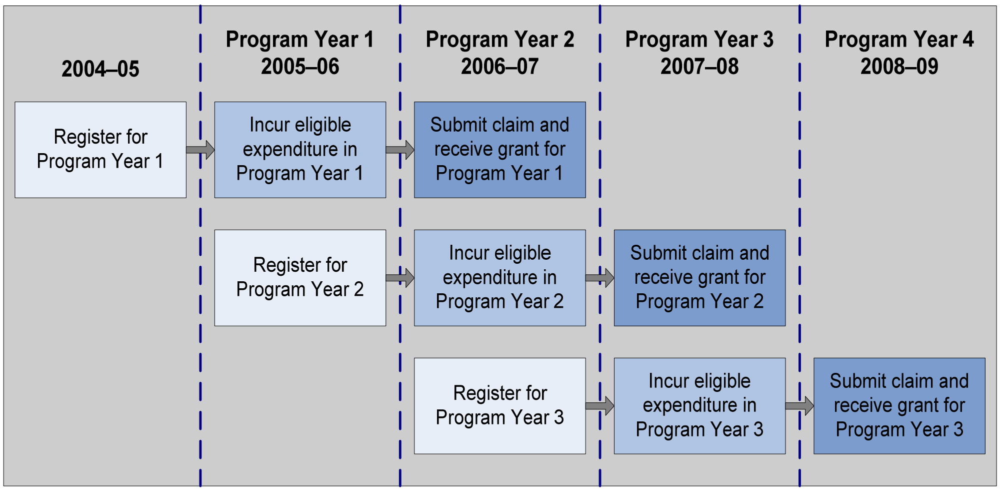
The TCF Post-2005 (SIP) Scheme

1.10 The statutory objective of the Scheme is to foster the development of a sustainable and internationally competitive TCF manufacturing industry and TCF design industry in Australia by providing incentives that will promote investment and innovation in the industry. Grant funding of up to $575 million is available to eligible TCF entities across two five-year periods – $487.5 million to eligible TCF sectors from 2005–06 to 2009–10; and $87.5 million to the clothing and finished textiles sectors only from 2010–11 to 2014–15.

1.11 Each year of the Scheme is referred to as a 'Program Year', which for most entities corresponds to a standard financial year ending 30 June.[19] To receive assistance, entities must register prior to the commencement of each Program Year, incur eligible expenditure in the Program Year, and then submit a claim to receive a grant payment in the financial year after each Program Year. This rolling, three-year cycle is illustrated in Figure 1.2.

Figure 1.2

Overview of the registration, expenditure and claim / payment cycle for the TCF Post-2005 (SIP) Scheme, for Program Year 1 to Program Year 3



Source: ANAO based on the *Textile, Clothing and Footwear Post-2005 Strategic Investment Program Scheme 2005*

[19] For those entities that use a 12-month accounting period, which does not end on 30 June, the Program Year corresponds to the applicable accounting period.

1.12 Entities that meet the eligibility requirements for the Scheme are able to access two types of grant payments—Type 1 grants provide up to 40 per cent of expenditure on eligible activities, while Type 2 grants provide up to 80 per cent of eligible expenditure. Table 1.3 lists the type of activities able to be claimed under these grants.

Table 1.3

Activities able to be claimed under the TCF Post-2005 (SIP) Scheme

Type 1 grants		Type 2 grants
Acquisition or construction of new TCF plant or equipment		Research and development
Acquisition or construction of new buildings or structures (or alterations) to house TCF plant or equipment as a consequence of acquiring new TCF plant or equipment		Innovative product design
Upgrading of existing TCF plant or equipment to meet environmental requirements		Innovative process improvement
Acquisition of new computer hardware or software, or development of new software		Market research
Participation in trade-showings and in-store promotions (brand support)		Obtaining industrial property rights
Non-production related information technology[20]		

Source: ANAO based on the *Textile, Clothing and Footwear Post-2005 Strategic Investment Program Scheme 2005*

1.13 After the end of each Program Year, entities can access scheme funds by lodging a claim for a grant payment, or by requesting an 'advance' of a grant payment (to be followed by a claim). Advances must not exceed 20 per cent of the eligible grant amount for Type 1 grants, or 40 per cent of the eligible grant amount for Type 2 grants. When claiming and receiving an advance or grant payment, entities must be undertaking an eligible TCF activity.

1.14 Total grant payments are capped at $97.5 million per year for the period 2005–06 to 2009–10 and at $17.5 million per year for the period 2010–11 to 2014–15.[21] If the total claims for scheme funds exceed the annual funding limit (as happened in Program Years 1 and 2), all claims are reduced through a modulation process to ensure that the annual funding cap is not exceeded. Some funding limits also apply to individual grant payments. This includes a five per cent cap, based on an entity's total eligible revenue for the Program

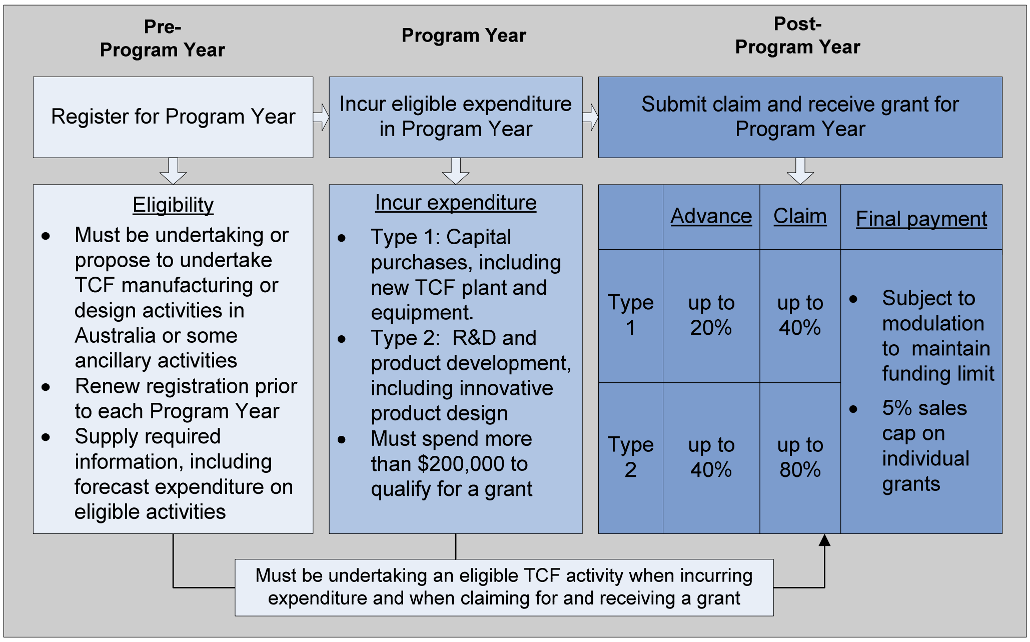
20 This grant is available only to entities carrying on eligible clothing or finished textile activities.

21 For Program Years 2006–07 to 2009–10 and 2011–12 to 2014–15, annual funding limits may include unspent funds from previous years, plus any deferred grant eligibility amounts.

Year.[22] An overview of the Scheme's key requirements for the registration, expenditure and claim cycle is provided in Figure 1.3.

Figure 1.3

Overview of requirements for the TCF Post-2005 (SIP) Scheme



Source: ANAO based on the *Textile, Clothing and Footwear Post-2005 Strategic Investment Program Scheme 2005*

Grant payments

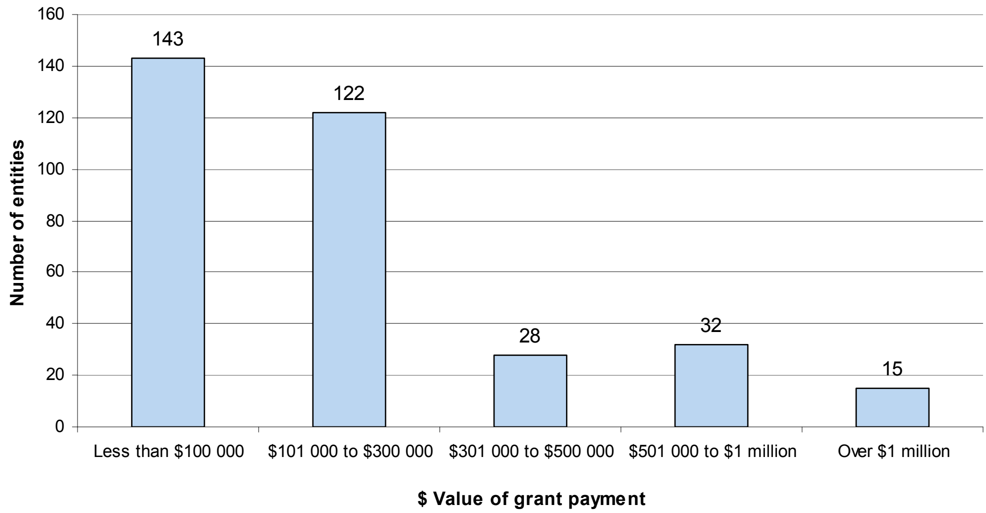
1.15 For Program Year 1, the department paid out $96.1 million in grants to 341 entities.[23] A list of grant recipients is provided on AusIndustry's website (www.ausindustry.gov.au). Payments ranged from a few hundred dollars to, in one case, over $6.4 million. However, as illustrated in Figure 1.4, the majority of grants were under $300 000.

[22] Total eligible revenue is defined in section 1.9 of the *Textile, Clothing and Footwear Post-2005 Strategic Investment Program Scheme 2005.* In general, it is the revenue derived from sales of the entity's eligible TCF products during the relevant period, except sales to New Zealand and excluding any GST, excise or sales tax, and any subsidy given during the period by the Commonwealth, or a State or Territory.

[23] A further $1.07 million in deferred grant eligibility amounts was set aside for subsequent Program Years.

Figure 1.4

Range of grant payments for Program Year 1, 2005–06, of the TCF Post-2005 (SIP) Scheme



Source: ANAO analysis of data provided by the Department of Innovation, Industry, Science and Research

1.16 A breakdown of the grant payments for Program Year 1, by industry sector, is provided in Appendix 3.

Legislative and administrative framework

1.17 The Scheme is established under the *Textile, Clothing and Footwear Strategic Investment Program Act 1999* (the Act) and a disallowable instrument, the *Textile, Clothing and Footwear Post-2005 Strategic Investment Program Scheme 2005* (the Scheme). The Act and Scheme are administered by the Department of Innovation, Industry, Science and Research (DIISR).[24]

1.18 AusIndustry, a service delivery division within DIISR, is responsible for the day-to-day administration of the Scheme. This includes: registering entities; assessing entities' advances and claims; paying grants and carrying out compliance and education activities. These functions are delivered by a team of around 16 staff from AusIndustry's State Office in Melbourne. A small policy group within DIISR's Manufacturing division, located in Canberra, is responsible for the policy and legislative framework for the Scheme.

[24] Prior to the change of government in November 2007, the Scheme was administered by the Department of Industry, Tourism and Resources.

External reviews of the TCF industry

1.19 Since 2000, there have been two external reviews of government assistance to the TCF industry. The first was in 2002, during the previous TCF SIP Scheme, and was undertaken by the Productivity Commission.[25] The second was in 2008, during the current Scheme, and was led by Professor Roy Green. The Terms of Reference for the 2008 review include an examination of the appropriateness and effectiveness of assistance provided under the 2005–2015 package, including the Scheme. Professor Green's report, *Building Innovative Capability*, was publicly released by the Minister in September 2008.

Audit objective, scope and methodology

1.20 The objective of this audit was to assess whether the Scheme is being administered effectively by the department. The ANAO focussed on Program Year 1 of the Scheme, 2005–06, and examined DIISR's arrangements for:

- assessing the eligibility of entities to receive grants;
- assessing entities' claims for eligible expenditure;
- adhering to the funding limits for the Scheme when calculating and paying claims, and managing any debts that arise; and
- evaluating and reporting on whether the statutory objective of the Scheme is being met.

1.21 The audit did not examine the other components of the 2005–2015 industry assistance package; nor did it examine any of the programs delivered under the previous assistance package (2000–2005).

Audit methodology

1.22 The audit methodology included: quantitative and qualitative analysis; examination of documentation and files; interviews with departmental staff; and discussions with some TCF participants and industry stakeholders.

1.23 The audit was conducted in accordance with ANAO auditing standards and cost $330 000.

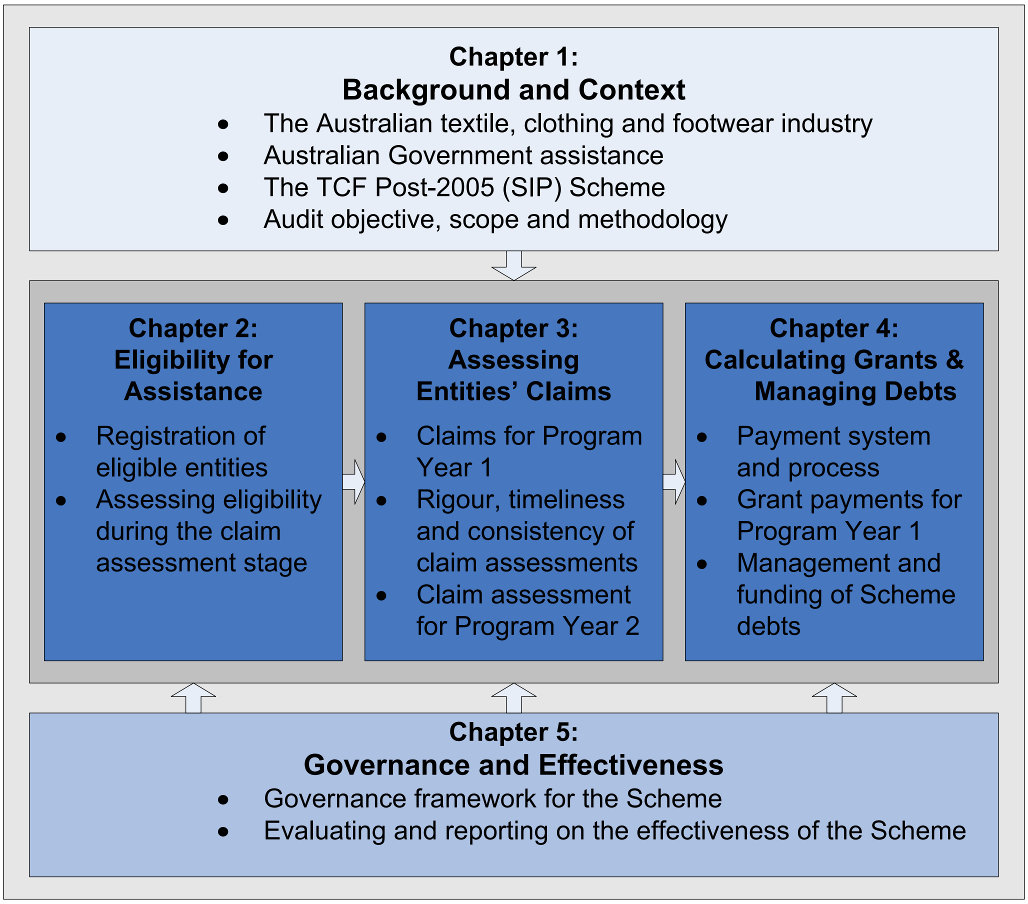
[25] Productivity Commission 2003, *Review of TCF Assistance*, Report No. 26, Canberra.

Report structure

1.24 The structure of the report is set out in Figure 1.5. Chapters 2 to 4 examine whether key aspects of the Scheme—eligibility, claim assessment and grant payments—are being administered effectively by AusIndustry; while Chapter 5 focuses on broader program management issues.

Figure 1.5

Chapter structure of the report



2. Eligibility for Assistance

This chapter examines the department's arrangements for assessing the eligibility of entities within the TCF industry to receive assistance under the Scheme.

Introduction

2.1 AusIndustry is responsible for assessing whether entities have met eligibility requirements before paying any grants under the Scheme, including:

- being registered before 1 July of the relevant Program Year;
- incurring more than $200 000 in eligible expenditure during the relevant Program Year(s)[26]; and
- undertaking an eligible TCF activity at the time of making a claim and receiving a payment in the financial year following each Program Year.

Registration of eligible entities

2.2 To make a claim for Program Year 1, 2005–06, entities needed to register before 1 July 2005, and those entities wishing to access scheme funds in subsequent Program Years must renew their registration by 1 July each year. As illustrated in Figure 2.1, registrations are higher under the Scheme than under the previous TCF SIP Scheme. DIISR advised that the higher levels of registration can be attributed to a range of factors including:

- efforts by consulting firms to actively recruit new entities to the Scheme following its announcement in 2003[27];
- provisions within the Scheme, which allow entities to count eligible expenditure in the last year of the TCF SIP Scheme, 2004–05, towards passing the $200 000 expenditure threshold under the Scheme; and
- higher levels of awareness within the industry, resulting in part from the department's efforts to promote the Scheme.[28]

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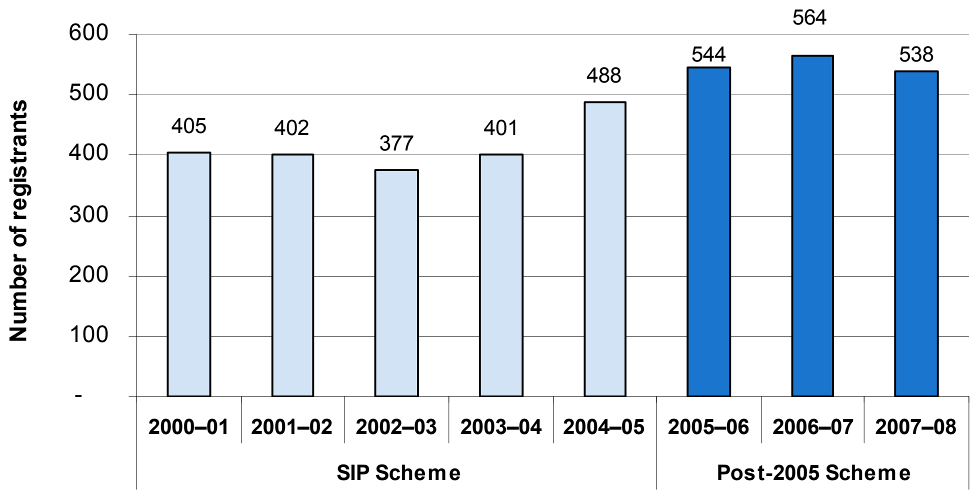
[26] Entities who do not exceed this expenditure threshold are able to apply for grants of up to $50 000 under the TCF Small Business Program, which is also administered by DIISR.

[27] In 2005–06, around 71 per cent of registered entities had engaged an agent to assist them in preparing their application for registration or subsequent claim.

[28] For example, the department held information seminars in all major capital cities in 2004; it liaises with industry bodies; and it maintains information on its website.

Figure 2.1

Entities registered under the TCF SIP Scheme and the TCF Post-2005 (SIP) Scheme, for the period 2000–01 to 2007–08



Source: ANAO based on data provided by the Department of Innovation, Industry, Science and Research

2.3 Registrations are expected to decline in the final five years of the Scheme (2010–11 to 2014–15) as funding in this period is available only to entities undertaking eligible clothing and finished textile activities. These entities made up 56 per cent of all registered entities for Program Year 4, 2008–09. The final claim year for all other TCF sectors is 2010–2011.

Registration requirements

2.4 To be eligible to register for the Scheme, an entity must be carrying on, or *propose* to carry on, an eligible TCF activity in Australia as defined in the legislation. These activities include:

- manufacturing of TCF products;
- design for manufacturing of TCF products; and
- ancillary activities, such as warehousing and distribution.

2.5 DIISR's application form captures key details about the entity's structure and business activities, including estimates of expenditure on eligible activities for the next two Program Years. These estimates allow the department to gauge whether the demand for scheme funds in the coming Program Year is likely to exceed the annual funding limit – as was the case in Program Years 1 and 2. For these two Program Years, entities' expenditure estimates were used to work out a provisional modulation rate by which all subsequent grant eligibility amounts may be reduced to adhere to the funding limit for the Scheme ($97.5 million in 2005–06). DIISR communicated the provisional modulation rates to entities via its customer newsletter, *TCF Strategic News*, to assist them with their cash-flow forecasts and to manage expectations about the level of grant payments.

2.6 Entities must also provide financial statements for the previous income year, and a statement of strategic business intent outlining how the entity plans to sustain operations 'beyond the end of the program period' — that is, 2014–15 for entities undertaking eligible clothing or finished textile activities, and 2009–10 for all other entities. These documents allow the department to:

- manage some risks associated with an entity's eligibility for a grant (for example, by having grounds to revoke a grant entitlement if it is found that an entity failed to disclose the true nature of its activities); and
- inform its compliance activities during the claim assessment stage (for example, by prompting a site visit to an entity's premises to confirm an entity's eligibility for assistance).

2.7 DIISR advised that, even if it has concerns about an entity remaining eligible for assistance during the life of the Scheme, it is legislatively obliged to pay an advance or grant to an entity that meets eligibility requirements at the time of making a claim and receiving a payment. This feature of the Scheme makes it particularly important for DIISR to have robust processes in place to confirm an entity's eligibility for assistance before any funds are provided. (This issue is discussed further in paragraphs 2.18 to 2.22.) Details provided by entities during their initial registration are required to be updated, as necessary, during each subsequent renewal of registration.

Applications for registration for Program Year 1

2.8 The ANAO examined a sample of 40 customer files for entities that received grant payments for Program Year 1 (around 10 per cent of all grant recipients). The file examination revealed that all 40 entities had:

- submitted an application for registration by 1 July 2005, or had been granted an extension of time in appropriate circumstances, as permitted under the Scheme;
- submitted a renewal of registration form by 1 July 2006 for Program Year 2, where relevant; and

- submitted the required information, including financial statements, statement of strategic business intent and expenditure forecasts.

2.9 Departmental staff followed standard processes when assessing applications for registration, as set out in the procedures manual. Follow-up queries were made in cases where information was missing or required clarification, and site visits were conducted for some new registrations. In all cases examined by the ANAO, a registration checklist was completed by a customer service manager (CSM) and approved by a team leader to confirm that registration requirements had been checked and met.

2.10 Although registration is a necessary condition of being able to claim and receive a grant, and assists DIISR to manage aspects of the Scheme, it does not by itself, give rise to any entitlement to a grant. For this reason, DIISR also monitors entities' eligibility for assistance during the claim assessment stage, when registered entities are able to seek access to Scheme funds.

Assessing eligibility during the claim assessment stage

2.11 As per the three-year cycle illustrated in Figure 1.1, entities that registered by 1 July 2005 were able to submit a claim for a grant payment in 2006–07. These claims related to eligible expenditure incurred in 2005–06, Program Year 1. Of the 544 entities that registered for that year, the department received claims from 374 entities, 68 per cent of all registered entities. In assessing the eligibility of these entities to receive a grant payment, DIISR was required to satisfy itself that the entity:

- was undertaking an eligible TCF activity at the time of making a claim and when receiving a grant (if eligible);
- had exceeded the $200 000 expenditure threshold on eligible investment activities in the relevant Program Year(s);
- that lodged the claim was the registered entity that undertook the eligible TCF activities in Program Year 1; and
- had met other Scheme requirements, including in relation to the disposal of plant and equipment.

Eligibility issues identified for Program Year 1

2.12 DIISR identified three instances, which are outlined in Table 2.1, where Scheme funds were provided to entities that were subsequently found to be ineligible for assistance. The department paid around $580 000 to these entities, which amounted to less than one per cent of total grant payments that year.

Table 2.1

Eligibility issues identified by the department for Program Year 1, 2005–06, of the TCF Post-2005 (SIP) Scheme

Failure of entities to lodge a claim following the payment of an advance

1. A manufacturer requested, and subsequently received, an advance payment of around $50 000 in December 2006. The department determined that the entity was eligible to be paid an advance. However, the entity was found not to be undertaking an eligible TCF activity at the time of making a claim in February 2007. As a result, the entity was required to repay the full amount of the advance, which it did in June 2007. The entity resumed eligible TCF activities and is therefore able to make further claims under the Scheme.

2. A manufacturer requested, and subsequently received, an advance of around $220 000 in September 2006. The department determined that the entity was eligible to be paid an advance. However, the entity was not eligible to make a claim as it ceased eligible TCF activities as a result of financial difficulties. Consequently, the entity was required to repay the full amount of the advance. This debt remained outstanding at 20 June 2008.

Transfer of registration between entities

3. An entity requested, and subsequently received, an advance and grant entitlement which totalled around $310 000. It was then discovered in the following year that the entity that received these funds was not the entity that undertook the eligible TCF activities. The activities were undertaken by an entity in the same corporate group, and the issue was identified when one entity sought a transfer of registration from the original grant recipient. Consequently, the full amount of the grant entitlement had to be repaid. The entity has appealed this decision and the matter is currently before the Administrative Appeals Tribunal.

Source: ANAO based on data provided by the Department of Innovation, Industry, Science and Research

2.13 The first two eligibility cases relate to an inherent design feature of the Scheme — which is that an entity may be eligible at the time of requesting and receiving an advance, but then become ineligible before being required to lodge a claim for a grant. This situation was less evident under the previous TCF SIP Scheme because grants were able to be paid when claims were received and processed, which meant that there was less incentive for entities to request an advance. This arrangement was possible because the demand for scheme funds under the TCF SIP Scheme never exceeded the available funding. Consequently, there was no need for the department to delay the payment of grants until all claims had been processed and modulated.

2.14 By contrast, in the first two Program Years of the Scheme, the demand for funds has exceeded the annual funding limit. As a result, no claim payments can be made until the department has received and assessed all claims, and worked out the appropriate modulation rate to ensure the annual funding limit is not breached. For the first claim year of the Scheme, this process was completed by 9 June 2007, some 11 months after the end of Program Year 1 and up to 23 months after entities incurred eligible expenditure in Program Year 1. The lapse of time in receiving a grant payment provides an incentive for entities to request an advance.

2.15 For Program Years 1 and 2, around two-thirds of all registered entities that lodged a claim also requested an advance. The more entities that request an advance, the greater the risk that some entities may lose their eligibility for assistance during the claim assessment period. The likelihood of this happening is increased by ongoing structural adjustment and change within the TCF industry, which can result in some entities moving their manufacturing operations offshore, being taken over by another entity or ceasing TCF activities altogether. This changing environment underlines the need for timely monitoring of entities' eligibility.

Eligibility issues identified for Program Year 2

2.16 The department advised that three entities were identified as being ineligible for Program Year 2, 2006–07. Two of these cases involved entities that received an advance, but were not eligible to make a claim and therefore had to repay the advance. The third case related to the failure of entities to transfer registration following the sale of a business. Total debts resulting from these cases amounted to $385 000, which, again, was less than one per cent of the total grants paid out that year.

Department's monitoring mechanisms

2.17 The ANAO assessed the department's processes and controls for gaining assurance that entities satisfy all eligibility requirements before receiving assistance under the Scheme. This assessment was based on a sample of 40 customer files (as per paragraph 2.8); a review of the three eligibility cases identified for Program Year 1; and discussions with departmental staff.

Undertaking eligible activities

2.18 The requirement that entities are undertaking an eligible TCF activity at the time of making a claim and receiving a payment—but not necessarily at other times—is perhaps the most challenging requirement for DIISR to monitor and verify. This requirement will affect entities differently, depending on when they claim and how they seek access to Scheme funds. For example, as illustrated in Figure 2.2, an entity that requested an advance and lodged a claim for Program Year 1 must have been undertaking an eligible TCF activity at four discrete periods:

(1) when requesting the advance, which could have been any time from 1 July 2006 to before the first working day in January 2007;

(2) when being paid the advance, which was usually within 60 days of the advance being requested, if the request was valid;

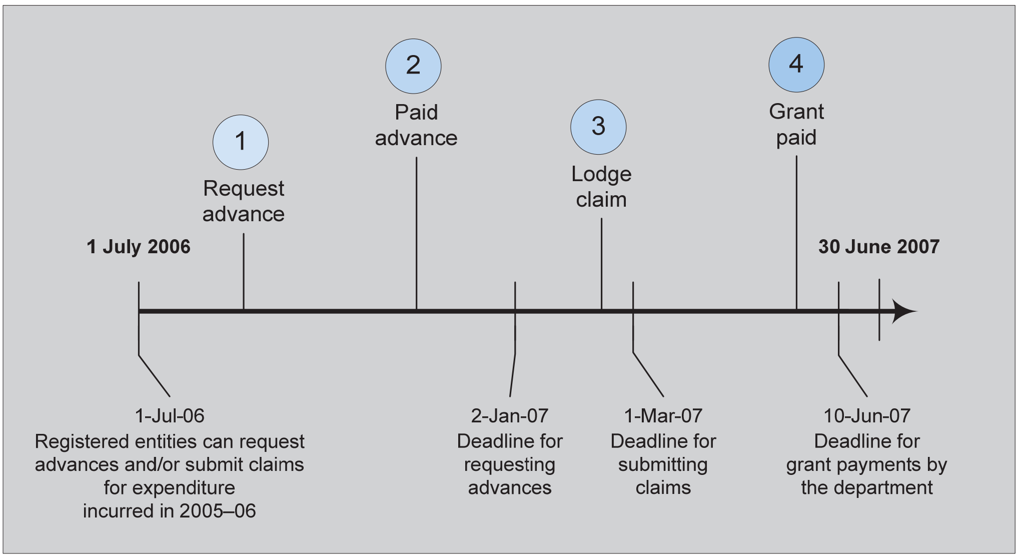
(3) when lodging a claim, which must have been before 1 March 2007; and

(4) when being paid the grant, which must have been before 10 June 2007.

2.19 In contrast, an entity that submitted a claim only for Program Year 1, and did not request an advance, must have been undertaking an eligible TCF activity at two discrete periods—at the time of lodging the claim (3), and at the time the grant was paid (4).

Figure 2.2

Key stages when an entity must be undertaking an eligible TCF activity in Australia, under the TCF Post-2005 (SIP) Scheme



Source: ANAO based on the *Textile, Clothing and Footwear Post-2005 Strategic Investment Program Scheme 2005*

2.20 The department does not independently verify that entities are undertaking an eligible TCF activity at each discrete period during the claim assessment and payment cycle. Instead, it requires entities to provide written declarations about their eligibility to receive assistance at each stage of the registration and claim process. It then seeks to confirm the veracity of these declarations through the following mechanisms, either in the actual claim year or during the three-year cycle for each Program Year:

- *desk-based assessment of claims*—customer service managers (CSMs) review the information provided on entities' claim forms and confirm that entities have declared that they are undertaking eligible TCF activities at the time of making the claim. Evidence of review and declaration was noted on all 40 files examined by the ANAO;
- *confirming the entity's current status*—the department conducts searches on the Australian Business Register (ABR) website, and the Australian Securities and Investment Commission (ASIC) website to confirm the entity is a registered business, and to identify any changes in the entity's status, which could affect its eligibility to receive grant entitlements (for example, if an entity is insolvent and is no longer undertaking eligible TCF activities). These searches are undertaken at various stages throughout the registration and claim cycle, and were noted on all files examined by the ANAO;
- *site visits to selected entities' premises*—these visits are conducted by the CSM assigned to each entity and are designed to educate and support entities, while encouraging compliance in a non-adversarial way. In 2005–06, DIISR conducted 110 site visits, which represented 29 per cent of all claimants. However, as discussed further in Chapter 3, most of these visits took place outside the claim and payment period, which limited their value in verifying that entities were undertaking eligible TCF activities as claimed; and
- *compliance appraisal visits*—these visits are conducted by staff that are not the entity's CSM, and involve an examination of the documentation and assertions supporting an entity's claim during the claim assessment period. These visits provide a useful mechanism for verifying that entities are undertaking eligible TCF activities. However, in 2005–06, only 15 entities had a compliance appraisal visit, four per cent of all claimants that year.

2.21 In addition to these specific mechanisms, DIISR relies on its staff building up knowledge of the Scheme's customer base, and of the TCF industry in general, in order to identify potential eligibility issues with entities. Also, DIISR can invoke debt recovery provisions under the Scheme and the *Financial Management and Accountability Act 1997* to address any eligibility issues that may be initially overlooked, but discovered through later checks.

2.22 Overall, the ANAO considers that DIISR has adopted a pragmatic and generally sound approach for assessing whether entities are undertaking an eligible TCF activity. However, the relative infrequency of CSM site visits and compliance appraisal visits during the claim assessment period limits the department's ability to gain first-hand assurance that this requirement is being met. As discussed in Chapter 3, DIISR's decision to introduce the self-assessment of claims for selected entities for Program Year 2 (and potentially beyond) provides an opportunity to take a more risk-based approach to claim assessment, and allows resources to be re-directed to higher risk activities. Priority can then be given to undertaking additional site visits or other checks to confirm the eligibility of entities to receive assistance.

Exceeding the $200 000 expenditure threshold

2.23 The department follows a two-pronged approach to confirm that entities have exceeded the $200 000 expenditure threshold on eligible activities:

- entities who lodge a claim are required to engage an independent auditor[29] to provide an opinion on whether the expenditure was incurred as claimed; and
- the department then assesses all claimed expenditure and either approves or rejects the items claimed.

Together these two checks provide reasonable assurance that the threshold has been met. Audit opinions were on all files examined by the ANAO and no issues with the expenditure threshold were noted.

2.24 Entities who request an advance are not required to attach an audit opinion verifying the eligible expenditure. In such cases (of which there were 240 in 2005–06) DIISR does not receive independent assurance that the threshold has been exceeded before it pays the advance. However, all entities who request an advance are also required to lodge a subsequent claim, to be accompanied by an audited statement. This provides DIISR with the ability to identify any discrepancies between the expenditure amounts in the advance and the subsequent claim and to make any necessary adjustments to the final grant.

Registered entity that lodges the claim

2.25 DIISR monitors the requirement that the entity that lodged the claim is the same entity that undertook the claimed activities in the Program Year by

[29] As registered under the *Corporations Act 2001*.

conducting searches on the ASIC and ABR websites, as noted earlier. Printouts from these searches were found on all 40 customer files examined by the ANAO, and no issues were noted.

2.26 Registered entities can apply to the department to have their registration transferred to another entity. This may happen, for example, during the sale of one business to another. The department has prepared a fact sheet to assist entities to understand their obligations in relation to the transfer of registration, which is available through its website. However, given that two cases arose in Program Year 1 and 2 where eligibility issues relating to the transfer of registration were identified, it may be appropriate for DIISR to reinforce existing guidance to entities on this matter.

Disposal of plant and equipment

2.27 Entities are required to notify DIISR if they have disposed of plant and equipment for which a grant has been made. This must be done either before the end of the program period, or after the end of the program period if the value of the plant or equipment at the time of disposal is not less than 70 per cent of the economic life of the plant or equipment when new.

2.28 To monitor this requirement, DIISR relies on entities making a declaration (in their claim form) which acknowledges their responsibility to notify the department of any disposal of plant and equipment; and it confirms, through checklists, that these declarations have been provided. This approach is probably adequate for the first few years of the Scheme, when the likelihood of disposal is low. As time progresses, however, DIISR may wish to place additional focus on this requirement, by, for example, undertaking further checks during site visits and compliance appraisal visits on entities that have received grants for new TCF plant and equipment. Such checks may be particularly important towards the end of 2010–11, the last claim year for many entities[30], and towards the end of 2015–16, the final claim year of the Scheme. It may not be realistic to expect entities to notify DIISR of the disposal of plant and equipment when they are no longer on the Scheme.

Conclusion

2.29 Overall, the department has adopted generally sound processes for confirming that entities meet their eligibility requirements. A risk inherent in the design of the Scheme is that entities may become ineligible for assistance

[30] As previously noted, from 2010–11 to 2014–15, the Scheme will be open only to entities from the clothing and finished textile sectors.

after receiving an advance payment, but before making a claim, and then owe a debt to the Commonwealth. The likelihood of this happening is increased by ongoing structural adjustment within the industry, which can see entities lose eligibility by ceasing TCF manufacturing or design activities or moving their manufacturing and design operations offshore. Changes of ownership can also affect an entity's eligibility for assistance. However, in the first two Program Years, only six cases were identified by the department where eligibility issues arose, and the resulting debts were not material in relation to the total grants paid out each year.

2.30 Nevertheless, the introduction of self-assessment for some claims provides DIISR with an opportunity to take a more targeted and risk-based approach to managing the Scheme's risks. This includes gaining a higher level of assurance of entities' eligibility through additional site visits during those periods when entities are required to be undertaking an eligible TCF activity. Ultimately, DIISR has the option to invoke its debt recovery powers to address eligibility issues that are initially overlooked, but identified in subsequent years.

3. Assessing Entities' Claims

This chapter examines the department's arrangements for assessing entities' claims for Program Year 1. It also discusses arrangements for Program Year 2 and beyond.

Introduction

3.1 Entities that satisfy the eligibility criteria for the Scheme are able to claim two types of grant funding for each Program Year:

- *Type 1 grants*—fund up to 40 per cent of expenditure on investment in new TCF plant and equipment and buildings, trade showings and in-store promotions and non-production related information technology; and
- *Type 2 grants*—fund up to 80 per cent of expenditure on investment in research and development, and product development activities.[31]

3.2 As previously noted, applications for grants are to be made in the financial year *after* the Program Year in which an entity incurred the eligible expenditure. To access scheme funds, entities may request an 'advance', followed by a claim for a grant, or lodge a claim only. Advances provide up to 50 per cent of the eligible grant amount for Type 1 and Type 2 grants. AusIndustry has to decide whether an entity is eligible for an advance or a grant within 60 days of receiving the application.

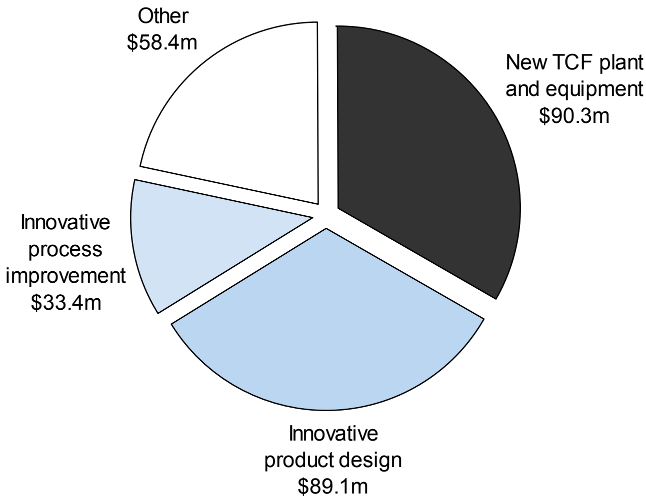
Claims for Program Year 1

3.3 For Program Year 1, the department received 374 claims from 544 registered entities, with 245 entities also requesting an advance payment. The remaining 170 registered entities did not request an advance or apply for a grant. The total amount of expenditure claimed by (but not paid to) entities was $271.2 million. As illustrated in Figure 3.1, the main items of claimed expenditure were: new TCF plant and equipment (Type 1 grant); innovative product design (Type 2 grant) and innovative process improvement (Type 2 grant).

[31] Namely, innovative product design, innovative process improvements, market research and obtaining intellectual property rights, such as patents.

Figure 3.1

Summary of expenditure claimed by entities for Program Year 1, 2005–06, of the TCF Post-2005 (SIP) Scheme



Source: ANAO analysis of data provided by the Department of Innovation, Industry, Science and Research

The claim process

3.4 In making claims, entities have to record their expenditure on eligible activities and, as relevant, to describe how the activity is eligible under the Scheme. For example, when claiming expenditure on innovative product design, entities must provide a detailed description of each relevant design project using the template provided by DIISR. The template prompts entities to provide information under the following key headings:

- what was the aim of the project (and was it successful)?;
- describe the functional or performance features of the product/design process (what makes the product/process unique?);
- provide examples of any key problems encountered and how they were resolved (the number of trials or prototypes developed); and
- how is the resulting product/design innovative?

3.5 As noted in Chapter 2, all claims (but not requests for an advance) are required to be accompanied by an independent auditor's report, which verifies the eligible expenditure.[32] Entities are not required to supply any additional evidence to support their claims, such as invoices or samples, although may be requested to do so by DIISR. However, they must retain all relevant documentation for five years from the date of receiving a payment. This allows the department to monitor compliance with the requirements of the Scheme.

Claim assessment methods

3.6 The Scheme provides the department with two options for assessing advances and claims: it allows self-assessment by entities, or the department may assess the claims. For Program Year 1, DIISR assessed all requests for advances and all claims. This approach was consistent with its coverage of claims during the previous TCF SIP Scheme.[33]

3.7 DIISR used four main methods to assess entities' claims for Program Year 1—desk-based reviews; independent auditor's reports; site visits by customer service managers (CSMs); and compliance appraisal visits to entities' premises, which are separate to site visits. A brief description of each method, and the coverage of claims, is outlined in Table 3.1.

3.8 The four main claim assessment methods are part of a broader compliance management strategy AusIndustry has developed to manage risks associated with its administration of the Scheme. This strategy is based on a division-wide compliance framework that involves four, inter-related, levels of compliance activity:

- Level 1: Customer education;
- Level 2: Internal compliance activities and site visits;
- Level 3: Compliance appraisal program visits; and
- Level 4: Full forensic audit activities.

3.9 The compliance management strategy is documented in an internal procedures manual and aspects of it are covered in the product plan and risk management summary for the Scheme, which are updated annually.

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32 See paragraph 6.4(1)(b) of the *Textile, Clothing and Footwear Post-2005 Strategic Investment Program Scheme 2005.*

33 Self-assessment was trialled on 17 claims in the last year of the TCF SIP Scheme, 2004–05.

Table 3.1

Claim assessment methods for Program Year 1, 2005–06

Method	Description	Coverage
Desk-based assessments	An examination of a claim form, discussion with applicants and completion of checklists, to confirm whether: • claimed expenditure was undertaken in respect of an eligible TCF activity and was incurred in the correct Program Year; • where necessary, was correctly apportioned between eligible and ineligible activities[34]; and • the claimed expenditure is an eligible Type 1 or Type 2 activity. These assessments are undertaken by the AusIndustry customer service manager assigned to each entity.	374 (all claimants)
Independent auditor's report	At the time of lodging a claim (but not an advance) entities must supply a report from an independent auditor verifying: • the total eligible revenue for the previous year; and • expenditure claimed for Type 1 and Type 2 activities. Auditors are selected by the entity and have no formal relationship with the department.	374 (all claimants)
Site visits	Site visits are designed to educate and support entities, while encouraging compliance in a non-adversarial way. They are conducted by the customer service manager assigned to the entity, and may be undertaken prior to, during, or after the 60-day claim assessment period.	110 (29 per cent of all claimants)
Compliance appraisal visits	An examination of claims for selected entities, at their premises, during the 60-day claim assessment period, prior to grant amounts being worked out. These visits involve an examination of the documentation and assertions supporting an entity's claim.	15 (four per cent of all claimants)

Source: ANAO analysis of data provided by the Department of Innovation, Industry, Science and Research

Rigour, timeliness and consistency of claim assessments

3.10 The ANAO examined the rigour of DIISR's claim assessment processes for Program Year 1, and the department's ability to identify, and reduce, the risk of mis-claiming. The timeliness and consistency of the claim assessment processes were also examined. These assessments were based on: an examination of 40 customer files (as per paragraph 2.8); review of an additional ten files where CSM site visits had been undertaken and five compliance appraisal visits; analysis of scheme data; and discussions with DIISR staff.

[34] For example, an entity may claim only half of the costs of new computer hardware (a Type 1 grant) if this percentage reflects the use of that hardware on eligible TCF activities.

Rigour of claim assessments

Desk-based assessments

3.11 All 40 claims in the ANAO's sample had been subject to a desk-based assessment. Claims were followed-up in various ways including through phone calls, emails, requests for samples or photographs, and in a few cases, through a site visit during the claim assessment period. On all files, a claim / determination checklist had been completed by the CSM and countersigned by a team leader. The checks included confirming that the claim was complete and had been signed and dated by the appropriate person. The ANAO confirmed that documents covered by the checklist were on file.

Auditors' reports

3.12 All claims also included an independent auditor's report, attesting that the revenue and expenditure amounts claimed by the entity had been substantiated, on a sample basis, by the auditor. DIISR has no formal relationship with auditors selected by entities, but it has developed sample audit guidelines, which are available via the department's website. Though useful, the sample guidelines refer to the previous TCF SIP Scheme and have not been updated to reflect the changes under the current Scheme.

3.13 The sample guidelines include standard letters for auditors to use when expressing their opinion, and include the following paragraph:

> Our audit has been conducted in accordance with Australian Auditing Standards. Our procedures have been undertaken to form an opinion on whether, in all material respects, the claim and request for determination is presented fairly in accordance with the requirements of the Textile, Clothing and Footwear (Strategic Investment Program) Scheme. The audit did not evaluate the level of compliance of [the entity] with the Textile, Clothing and Footwear (Strategic Investment Program) Scheme, nor did it seek to clarify [the entity's] interpretation of terms defined under the scheme.

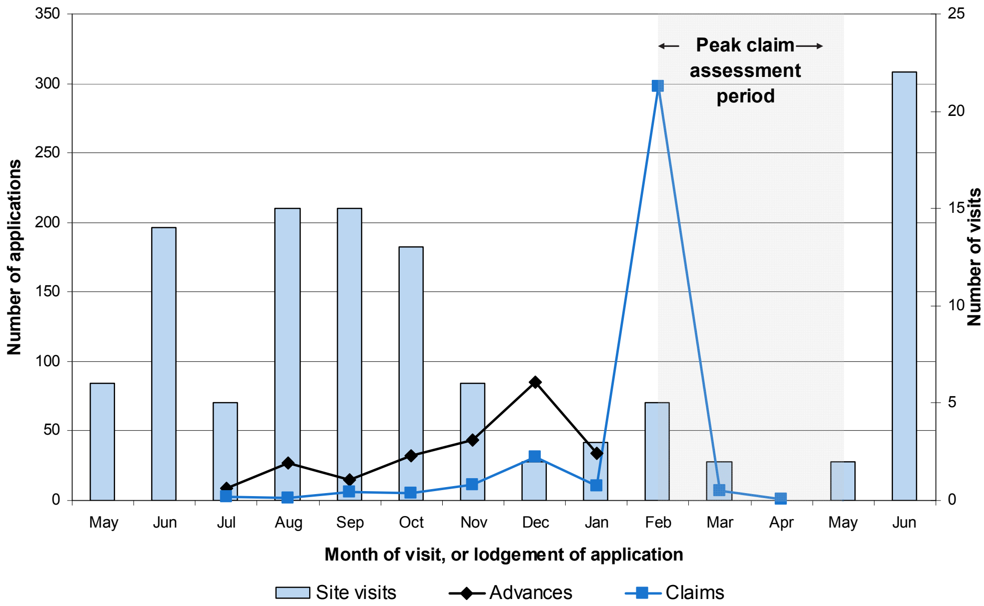
3.14 However, as noted in Chapter 2, the Scheme requires entities to provide an auditor's report verifying the *eligible* expenditure. Accordingly, the ANAO considers there is scope to more clearly align the nature of the assurance provided by the independent auditors with the requirements of the legislation.

Site visits

3.15 The ANAO examined an additional 10 customer files where site visits were undertaken for Program Year 1. In each case, the CSM produced a site visit report, which described the issues discussed during the visit and noted any matters relevant to the entity's eligibility for assistance and the nature of their claim. Site visits provide DIISR with the opportunity to examine an entity's operations first-hand and to sight any activities claimed in the previous year, or about to be claimed. However, as illustrated in Figure 3.2, the majority of site visits took place either before or after the peak claim assessment period from February to May 2007, when the bulk of claims were received and processed.

Figure 3.2

Analysis of site visits and lodgement of advances and claims for Program Year 1, 2005–06, of the TCF Post-2005 (SIP) Scheme



Source: ANAO analysis of data provided by the Department of Innovation, Industry, Science and Research

3.16 The main reason for site visits not being undertaken during the peak claim assessment period is because DIISR faced resource constraints in meeting the 60-day timeframe for processing the advances and claims. This situation was compounded by the department's decision to assess all claims, rather than allowing appropriate claims to be self-assessed. Overall, this approach limited the usefulness of site visits as a mechanism for verifying the expenditure claimed by entities, especially in relation to innovation activities (as discussed in paragraphs 3.19 to 3.22).

Compliance appraisal visits

3.17 The ANAO examined five compliance appraisal reports completed for Program Year 1 and accompanied DIISR on a compliance appraisal visit for Program Year 2. The reports were thorough and well-documented, and no issues were noted during the appraisal visit. All compliance appraisal visits for Program Year 1 took place in the 60-day period after claims were received, which provided the opportunity for the department to identify any mis-claimed amounts before grants were calculated and paid. These visits also provide a means to validate the work performed by the independent auditors.

3.18 In selecting entities for a compliance appraisal visit DIISR uses a risk-based approach, which gives consideration to factors such as the entity's claim and compliance history, the amount claimed and the type of activities being claimed. This approach aims to target visits towards those entities that present the greatest risk of mis-claiming, whether through lack of knowledge about the Scheme, a desire to test its boundaries, or outright fraud. For Program Year 1, the net impact of the 15 site visits was a downward adjustment of around $1.7 million on claimed expenditure, and a downward adjustment of some $8.3 million on total eligible revenue (which determines the maximum grant entitlement that entities can receive).

Assessing claimed expenditure on innovation activities

3.19 For Program Year 1, the expenditure claimed by entities on innovation activities amounted to $130 million, 49 per cent of all claimed expenditure. One of the challenges that DIISR faces in assessing these claims is that the Scheme does not define 'innovation'. Instead, it provides general criteria on activities that are considered not to be innovative. For example, for innovative product design, an activity ceases to be innovative if it is '... routinely undertaken or is directed solely at achieving visual product differentiation.'[35] This approach requires entities and the department to exercise judgement in determining which activities qualify for support. A fact sheet on *Innovation* published by the department in April 2005 states that its approach to assessing innovation is to examine each case on its merits.

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[35] See subsection 2.7(2) of the *Textile, Clothing and Footwear Post-2005 Strategic Investment Program Scheme 2005*.

Reliance on entity's assertions

3.20 Expenditure claimed on innovation activities is typically subject to a desk-based assessment only during the 60-day claim assessment period. This is because:

- independent auditors provide an opinion only on whether claimed expenditure was incurred, and was claimed in the correct accounting period; not whether the particular activity to which the expenditure relates (for example, product innovation) is eligible under the Scheme;
- compliance appraisal visits tend to focus more on whether the amounts claimed by entities can be substantiated, rather than on whether such activities are eligible (which is the primary role of the CSM); and, in any case, only a small number of such visits are undertaken each year; and
- most site visits did not take place during the 60-day claim assessment period, limiting their usefulness in verifying that innovation activities took place as claimed.

3.21 The department advised the ANAO that desk-based assessments are undertaken against a background of significant knowledge about individual customer activities, capabilities and claim history built up over the course of the Scheme and its predecessor, the TCF SIP Scheme. However, unlike some other types of claims (for instance, new TCF plant or equipment), claims for innovation may not be readily supported through invoices or other documentary evidence, limiting the value of a desk-based assessment. As a result, the department tends to rely more heavily on the entity's assertions (as outlined in the claim form), rather than verifying that innovation activities took place as claimed.

3.22 DIISR has recognised the challenges of verifying innovation claims. During the previous TCF SIP Scheme, it considered using a panel of experts to assess such claims. However, it advised that a number of factors worked against this approach including cost, independence of potential panel members and commercial confidentiality.

Timeliness and consistency of claim assessments

3.23 For Program Year 1, requests for an advance of a grant had to be lodged before 2 January 2007, and claims for a grant had to be lodged before 1 March 2007. The department had 60-days to determine whether the entity was eligible for a payment. This requirement was met on all 40 customer files examined by the ANAO. In a sample of other files, where DIISR's management system indicated that the 60-day time limit had not been met, the timeframe had been extended, as permitted under the Scheme, because the department had sought further information from the entity to assist in making its decision.

3.24 The ANAO did not identify any instances in its sample of 40 customer files where like claims were treated differently. Discussions with CSMs, who are responsible for conducting desk-based assessments and site visits, did reveal some variation in their understanding of how to assess innovation activities. For instance, some staff indicated that innovation is assessed at the entity level only, whereas other staff indicated that activities must be innovative to the industry, and not just to the entity concerned. However, DIISR has implemented the following measures to address any variation by CSMs and to facilitate a consistent approach to claim assessment:

- *Team leader review and delegate approval*—all desk-based assessments undertaken by the CSM are first reviewed by a team leader and then subject to scrutiny and formal approval by the delegate. On all 40 claim files examined by the ANAO, there was evidence of review of key documents and approval by the delegate; and
- *Documented policies and procedures*—DIISR's claim assessment process is documented in an internal procedures manual, which contains checklists, samples letters and templates to assist staff in assessing claims. A separate manual sets out procedures relating to the conduct of compliance appraisal visits. On all 40 claim files examined, the various checklists had been completed by the CSM.

3.25 Entities who are dissatisfied with certain decisions made by the department, including whether their claimed expenditure was rejected, can seek a reconsideration of that decision and /or make an application to the Administrative Appeals Tribunal for a review of the decision. Since the Scheme began, there have been 47 requests for reconsiderations, 38 of which have resulted in the original decision being revoked or varied by DIISR.[36] There have also been three appeals to the Administrative Appeals Tribunal, one of which has been heard by the Tribunal and was upheld in DIISR's favour. The two remaining cases have yet to be heard.

[36] Entities are allowed to submit additional information during the reconsideration process, which may not have been supplied during their original claim.

Outcome of claim assessments for Program Year 1

3.26 For Program Year 1, DIISR paid a total of $96.1 million in grant entitlements to entities, based on its assessment of 245 advances and 374 claims. Of the $271.2 million in investment activities claimed by entities, the department rejected $11.8 million in claimed expenditure (around four per cent of the total). The two highest rejected activities, by dollar value, were:

- trade showings and in-store promotions (Type 1 grant) which amounted to $6.2 million; and
- innovative product design (Type 2 grant) at $3.9 million.

Rejected items in the other expenditure categories totalled $1.7 million.

3.27 DIISR advised the ANAO that the $6.2 million of rejected expenditure for trade showings and in-store promotions for Program Year 1 may have been the result of confusion among some entities relating to the different treatment of these activities under the TCF SIP Scheme.[37] A fact sheet providing guidance on claiming eligible expenditure was posted on the department's website in April 2005 before Program Year 1 commenced. The level of rejected claims for expenditure on innovative product design could reflect the fact that the Scheme does not define 'innovation', leaving it open to interpretation as to which activities qualify for support. Currently, the department does not publish a list of rejected items of claimed expenditure, to minimise the risk of future mis-claiming.

Claimed expenditure not approved for Program Year 2

3.28 Claim assessments for Program Year 2, 2006–07, took place outside the timeframe for this audit. However, the department advised that total claimed expenditure was $244.4 million, around $5.9 million of which was found to be ineligible. This is almost half of the amount of ineligible expenditure identified by DIISR for Program Year 1.

Conclusion

3.29 DIISR follows well-documented and timely processes for assessing entities' requests for advances and claims. The combination of desk-based reviews, independent auditor's assurance, site visits and compliance appraisal

[37] Under the previous TCF SIP Scheme, trade showings and in-store promotions was called brand support, and claimed expenditure under this category had to be linked to an innovative activity; whereas, under the current Scheme, there is no requirement for expenditure on trade showings and in-store promotions to be linked to an innovative activity.

visits for selected entities provided coverage of all claims and enabled key aspects of claims to be verified. Some $11.4 million (or four per cent) of the expenditure claimed by entities was found to be ineligible.

3.30 However, the claim submission pattern for Program Year 1, put pressure on DIISR's resources, and it restricted the type of compliance activities able to be undertaken during the peak assessment period from February to May 2007. In particular, most site visits to entities' premises were undertaken either prior to February 2007, or after grants were paid in June 2007. The relative infrequency of site visits during the peak claim assessment period impacted on DIISR's ability to verify entities' claims for innovation, which made up almost half of all claimed expenditure. As a result, the department tended to rely on entities' assertions, rather than verifying that innovation activities took place as claimed. This approach may expose the department to higher levels of mis-claiming than were identified; but it also reflects the challenges of verifying innovation claims, which are not defined under the Scheme.

Claim assessment for Program Year 2 and beyond

3.31 In March 2008, DIISR made a decision to introduce self-assessment on selected claims for Program Year 2 (and potentially beyond). This decision was prompted by a need to more evenly redistribute resources across the year, to avoid the peak workload pressures experienced for Program Year 1, and as a means to better target higher risk claims.

3.32 For Program Year 2, the department received 378 claims from a total of 564 registered entities. Of these, 60 claims were self-assessed (15 per cent of all claims lodged). In practice, this meant that these claims were approved and paid, without being subject to a full desk-based assessment. However, all entities were still required to provide an independent auditor's report as part of their claim, and may have undergone a previous site visit.

3.33 In determining which claims were suitable for self-assessment, the department developed a risk rating process, to identify those entities who present a higher risk of making non-compliant claims. Those entities with a higher risk rating were subject to a full assessment by the department, while those entities with a lower risk rating were deemed suitable for self-assessment. DIISR advised that it intends undertaking post-payment checking of selected entities whose claims were self-assessed. A decision on the use of self-assessment for Program Year 3 will then be made when the department has reviewed the outcome of self-assessment for Program Year 2.

Benefits of a risk-based approach to claim assessment

3.34 Self-assessment allows the department to adopt a more risk-based approach to assessing claims. If implemented effectively, it will free up resources during the peak claim assessment period, allowing DIISR to focus these resources on higher risk entities, verifying aspects of their claims, and eligibility for assistance. There is scope for DIISR to extend the benefits of such an approach by enhancing aspects of its compliance management strategy. This includes refining its program of site visits, to target higher-risk entities during the 60-day claim assessment period. The decision on which entities to visit should be informed by a rigorous risk assessment process, as is currently used to determine which entities will undergo a compliance appraisal visit.

3.35 There is also scope for the department to further educate and inform entities on appropriate claiming behaviour, particularly in a self-assessment environment. The department currently informs individual entities of the reasons why items of claimed expenditure were rejected, and it uses communication tools, such as the TCF newsletter, to educate the broader claimant group on ways to lodge accurate claims. However, the ANAO considers that another useful educative tool would be for DIISR to publish a concise document at the end of each Program Year, which outlines the types of activities that were not supported in claims. Publishing this information might prompt entities to seek advice from DIISR on the validity of their (intended) claims, and to amend their claiming patterns in the following year, to conform to the department's assessment approach. Another measure that can be taken to reduce mis-claiming is to review and, where necessary, update guidance material to ensure it includes examples of the types of activities that are claimed by entities, but which are not approved by the department.

3.36 The justifications for a more risk-based approach to claim assessment are even stronger for the final five-year stage of Scheme, when funding drops from $97.5 million per annum to $17.5 million, and when grants are available only to entities involved in clothing and finished textile activities.

Conclusion

3.37 DIISR's decision to introduce self-assessment for selected claims in Program Year 2 (and potentially beyond) provides an opportunity to adopt a more risk-based approach to claim assessment, including verifying innovation activities. Resources that are freed-up from assessing claims deemed to be lower-risk can be used to target certain types of entities or claims assessed as a higher risk. There is scope for the department to enhance aspects of its compliance framework to extend the benefits from the use of self-assessment. This includes refining its program of site visits, to target higher-risk entities during the 60-day claim assessment period, and providing feedback to entities on the types of claim that are not supported for a Program Year, to minimise the risk of future mis-claiming. Guidance material also needs to be regularly reviewed and, where necessary, updated.

Recommendation No.1

3.38 To enhance its compliance management strategy for the Textile, Clothing and Footwear Post-2005 (SIP) Scheme, the ANAO recommends that the Department of Innovation, Industry, Science and Research:

(a) refine its program of site visits, to target higher-risk entities during the 60-day claim assessment period;

(b) provide additional feedback to entities on the types of claims that are not supported, to minimise the risk of mis-claiming in the following Program Year(s); and

(c) regularly review and, where necessary, update guidance material for scheme participants.

Department's response

3.39 Agreed.

4. Calculating Grants and Managing Debts

This chapter examines the department's processes for calculating entities' grant entitlements, taking into account the funding limits of the Scheme. It also assesses DIISR's processes for managing debts incurred during the claim assessment cycle.

Introduction

4.1 The department determines the final grants to be paid to an entity after it takes into account:

- the amount of any advance provided;
- the requirement for grants not to exceed five per cent of an entity's total eligible revenue in the previous financial year; and
- the need to accommodate all grant payments within the annual funding limit for the Scheme ($97.5 million in Program Year 1).[38]

All grants must be paid by 10 June after the end of each Program Year.

Payment system and process

4.2 DIISR uses its Integrated Program Management System (IPMS) to calculate grant entitlements and to maintain the registration details of entities. Payments within IPMS are calculated using figures entered by CSMs during the assessment of claims.[39]

4.3 The IPMS was also used to calculate grants entitlements for the previous TCF SIP Scheme. However, because of differences in entitlements available under each scheme and the introduction of new modulation calculations, significant changes had to be made to IPMS to facilitate payments under the new Scheme by 10 June 2007. These changes were carried out by DIISR's eBusiness division and included:

- developing a 'system calculator' to calculate grants for entities, in accordance with the requirements of the Scheme; and

[38] The full list of payment factors for the Scheme is provided in Appendix 4.

[39] These figures are checked to confirm that they match the amounts approved by the delegate.

- preparing a procedures manual, known as the 'calculation document', to describe the calculations performed by the system calculator.

4.4 The changes made to the IPMS by eBusiness were subject to DIISR's application development methodology and approval processes. These included system testing, user acceptance testing and IT change management.

External review of IPMS

4.5 Due to the relative complexities involved in calculating entities' grant entitlements for Program Year 1, the department engaged an external consultant to review the calculation document and to test the system calculator. The intention was to gain an independent opinion on whether the system would support correct payments for Program Year 1 and beyond, as this was seen to be a key risk to the effective delivery of the Scheme.

4.6 During its initial review of the IPMS, which commenced in September 2006, the consultant found that there was a fundamental difference of opinion within DIISR as to the appropriate basis of the payment system. AusIndustry considered that payments should be made on a 'cash' basis. This would allow all payments under the Scheme, including debts and any legal matters, to be funded out of the annual appropriation for the Scheme. In contrast, the Manufacturing division, which is responsible for the legislative framework for the Scheme, considered that payments should be made on an 'accruals' basis. This would allow only advances, grant payments and unacquitted advances[40] to be funded out of the annual appropriation, not other Scheme debts or legal matters.

4.7 AusIndustry and the Manufacturing division shared the same objective of ensuring that the annual funding limit for the Scheme was not exceeded. However, they differed in their interpretation of how the legislation intended this to be achieved. This issue was resolved in May 2007 by the Manufacturing division 'directing' AusIndustry to develop the payment system on an accruals basis, in accordance with its interpretation of the Scheme.[41] This was four weeks before the payment deadline for Program Year 1 (10 June 2007) and around eight months after AusIndustry had originally asked eBusiness to develop a cash-based system. The consequences of this approach on the

[40] The department uses the phrase 'unacquitted advances' to refer to advances that are requested by entities and duly paid, but not followed up by a claim for a grant as required under the Scheme.

[41] Based on legal advice from the Australian Government Solicitor's office.

management of scheme debts is discussed in paragraphs 4.26 to 4.29, and the governance implications are considered in Chapter 5.

Testing of payment scenarios

4.8 Following the department's decision to develop the payment system on an accruals basis, the eBusiness division amended the system calculator and associated documentation. The external consultant then developed an independent payment system (in Microsoft Excel) to run hypothetical payment scenarios in parallel to the IPMS.[42] In mid-May 2007, the IPMS and the parallel system were producing the same results to the cent, giving the department assurance that the system was reliable and robust. The consultant also found that the calculations were accurately documented, and in accordance with the requirements of the Scheme. AusIndustry also tested IPMS prior to making any payments for Program Year 1. This testing also found that the grant and modulation calculations were correct.

ANAO review of payment system

4.9 Given the extensive testing of IPMS prior to Program Year 1, the ANAO did not recalculate payments for this period. Instead, the ANAO reviewed the payment system within IPMS, both for Program Year 1 and the new functionality for Program Year 2 (which mainly covered debt management). The scope of the ANAO's review covered system testing, user acceptance testing and IT change management.

4.10 Overall, the ANAO confirmed that:

- appropriate IT change management procedures and quality assurance controls were in place to preserve the completeness, accuracy and reliability of Scheme data; and
- appropriate application controls were in place to ensure the correct calculation of payments, and that scheme funds are managed within legislative funding parameters.

Together, these findings indicate that IPMS is a reliable system to support the delivery of the Scheme.

4.11 Aspects of the methodology, and associated test plans, to support the development of the IPMS were not documented or subject to formal review. For example, no formal test plan was prepared to cover the development of

[42] This was undertaken for both the cash-based payment system initially commissioned by AusIndustry and then the accruals-based payment system mandated by the Manufacturing division.

scheme debt functionality for Program Year 2 (although there was ongoing contact between the system development staff and the testing staff). The absence of such plans reduces the traceability of system changes, which could impact on any further development of the IPMS. However, tight development timeframes and resourcing issues contributed to this situation.

Grant payments for Program Year 1

4.12 The different combinations of payment factors (as listed in Appendix 4) require the department to undertake relatively complex calculations before determining the correct entitlement for each entity. This is particularly relevant to the last four years of the Scheme when the deferred grant eligibility amounts[43] and excess amounts[44] can be accessed, and the range of payment scenarios increases. For Program Year 1, however, the main factors that added complexity to the calculation of grant entitlements was the need for the department to apply the five per cent sales-capping provisions of the Scheme to certain entities, and to modulate all grants payments to prevent the annual funding limit of $97.5 million from being exceeded. As well, excess amounts and deferred grant eligibility amounts had to be properly recorded and carried over into Program Year 2. A summary of each payment factor is provided below.

Modulation

4.13 For Program Year 1, the total amount of claimed eligible expenditure assessed by DIISR was $259.4 million. If these claims had been paid at the maximum rate, this would have generated grants of $132.4 million, which would have exceeded the annual funding limit of $97.5 million. The department was therefore required to modulate all claims according to the formula set out in the Scheme.[45] The modulation rate was worked out to be 0.73, which meant that entities were entitled to receive 73 cents for every dollar they were otherwise eligible to receive. For example, an entity whose grant eligibility was calculated to be $1 million would receive $730 000.

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43 If an entity has invested in eligible activities, but has not exceeded the $200 000 threshold, the eligible grant amount (adjusted by modulation) is set aside to a subsequent Program Year until the threshold is reached.

44 If an entity has their entitlement capped by the five per cent sales cap, the excess eligible grant amount (adjusted by modulation) can be carried over to the next Program Year.

45 Section 6.20 of the *Textile, Clothing and Footwear Post-2005 Strategic Investment Program Scheme 2005*.

Sales-capping and excess amounts

4.14 For Program Year 1, 186 of the 374 entities who lodged a claim were subject to the sales-capping provisions of the Scheme. These provisions require that the total grant payable to an entity must not exceed five per cent of the total eligible revenue of the entity for the previous income year. For example, if an entity's total eligible revenue in 2005–06 was $1 million, then the total grant payable for Program Year 1 would be capped at $50 000. Sales-capping occurs prior to any modulation rate being applied. Thus, a sales-capped amount of $50 000 would be reduced to $36 500 once the modulation rate of 0.73 was applied.

4.15 The Scheme allows entities to carry-over the eligible grant amount in excess of the sales-capped amount into the next Program Year, which can then be counted towards the eligible grant amount for that year. However, the excess amount is also subject to modulation and must be claimed in the following year. This would be added to the Program Year 2 eligible grant amount.

Deferred grant eligibility amounts

4.16 For Program Year 1, 33 of the 374 entities that applied for a grant did not exceed the $200 000 threshold on eligible expenditure under the Scheme, and were therefore not entitled. However, the amount of the claimed expenditure found to be eligible is carried over as deferred grant eligibility amounts. These amounts are set aside for future Program Years to satisfy any claim where the entity does exceed the $200 000 threshold. The deferred amounts for Program Year 1 totalled $1.07 million and, for entities, ranged from $1200 up to $102 000. The ANAO confirmed that the total amount deferred for Program Year 1 had been properly set aside for Program Year 2.

Final grant payments

4.17 Grant payments for Program Year 1 were made in the period 31 May 2007 to 7 June 2007, prior to the payment deadline of 10 June 2007. Table 4.1 provides a summary of the payments, while the corresponding figures for Program Year 2 are provided in Appendix 5.

Table 4.1

Summary of payments for Program Year 1, 2005–06, of the TCF Post-2005 (SIP) Scheme

Type of payment	Description	No. of entities	Total $
Advances (a)	Amounts paid prior to determination of final grant entitlements	240	49 776 234
Final claims (b)	Final payments following the determination of claims	340	47 883 779
Total payments (c)	Advances (a) plus final claims (b)	342[1]	**97 660 013**
Deferred grant eligibility amounts (d)	Total funding related to deferred amounts from Program Years 1	33	1 079 570
Scheme debts – partially acquitted advances (e)	Overpayments resulting from a difference between the final claim determination and the advance of a grant already paid	50	1 239 587
Scheme debts – unacquitted advances (f)	Overpayments resulting from advances that were paid (a) but not followed by an eligible claim, as required under the Scheme	2	270 862
Total Scheme debts (g)	Partially acquitted advances (e) plus unacquitted advances (f)	**52**	**1 510 449**
Total entitlements (h)	Total payments (c) minus total Scheme debts (g)	**340**	**96 149 564**
TOTAL FUNDING	Total entitlements (h) plus deferred eligibility amounts (d) plus unacquitted advances (f)	**375**	**97 499 997**

Note 1: The difference between the number of entities final claims (b) and for total payments (c) is due to two entities receiving unacquitted advances (f) to which they were not subsequently entitled

Source: ANAO analysis of data provided by the Department of Innovation, Industry, Science and Research

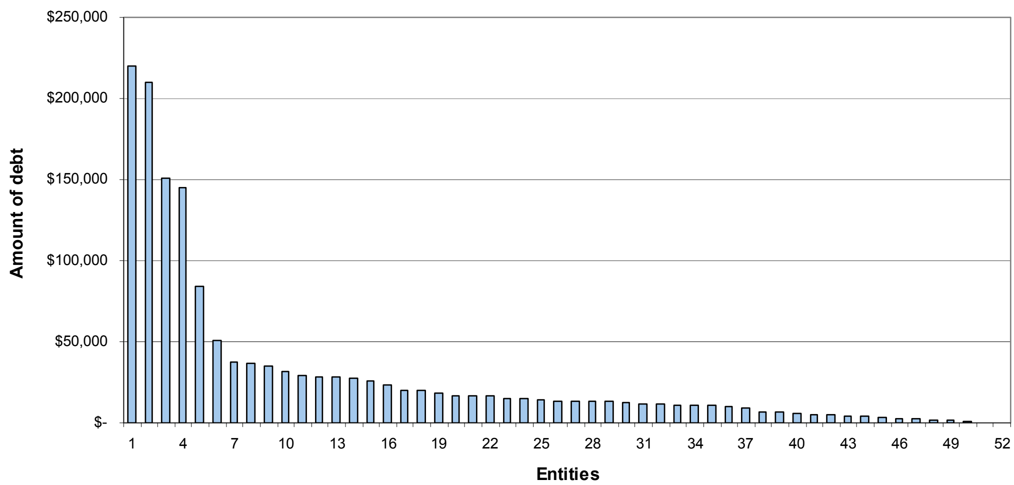
4.18 In late 2007, AusIndustry conducted a review of all payments made for Program Year 1 to verify whether the correct entitlement had been paid. During the review, two claim determinations were found to contain an error. However, the net impact on Scheme funds was negligible—one involved an overpayment of $8550; the other an underpayment of $4911. In all other cases, grant amounts were found to be calculated according to system specifications, and determined entitlements had used the correct modulation factor.

Management and funding of Scheme debts

4.19 In Program Year 1, $1.51 million in scheme debts were identified, relating to 52 separate entities. Individual debts ranged from $201 to $219 000; however, as illustrated in Figure 4.1, all but six debts were under $50 000.

Figure 4.1

Range of debts identified for Program Year 1, 2005–06, of the TCF Post-2005 (SIP) Scheme



Source: ANAO analysis of data provided by the Department of Innovation, Industry, Science and Research

4.20 Of the 52 debts identified, 50 debts resulted from entities receiving more in an advance payment than their final grant entitlement allowed. The remaining two cases involved entities that received an advance payment, but either did not lodge a final claim, or were found to be ineligible for assistance when their claim was lodged. These two cases are discussed in Chapter 2.

4.21 The key reasons leading to the advance-related debts in Program Year 1 can be summarised as follows:

- the Scheme allows 50 per cent of an entity's eligible expenditure to be paid as an advance.[46] However, unlike claim determinations, advance payments are not subject to sales-capping or to modulation;
- the Scheme delegate (from AusIndustry) approved the payment of all advances at the maximum level available under the Scheme—50 per cent. This followed the approach taken in the previous TCF SIP

[46] That is, 20 per cent for eligible Type 1 activities and 40 per cent for eligible Type 2 activities.

Scheme and was designed to provide benefits to entities in a timely manner, in accordance with policy intent of the Scheme;

- when all claims had been received for Program Year 1 (by March 2007), the combination of sales-capping and a lower than expected modulation rate of 0.73 meant that the advances already received by the 50 entities exceeded their final entitlement; and the overpaid amounts became a debt.

4.22 Importantly, the 50 debts that were raised for Program Year 1 were not considered by DIISR to be the result of attempts by entities to mislead it. Rather, the advance payments were received in good faith, even though they were subsequently determined to exceed each entity's final grant entitlement.

Minimising debts in Program Year 2 and beyond

4.23 DIISR took a number of steps to minimise the risk of debts occurring in Program Year 2 and beyond. It sought amendments to the Scheme under section 37ZF of the *Textile, Clothing and Footwear Strategic Investment Program Act 1999* (the Act), which came into effect on 30 June 2007. These included:

- preventing entities from requesting an advance if a scheme debt exists and has not been paid; and
- requiring entities to estimate their total eligible revenue at the time of requesting an advance (which determines the maximum five per cent in entitlements that entities are permitted to receive).

4.24 New processes have also been put in place within AusIndustry to complement the amendments to the Scheme. Factors such as the five per cent sales cap and a 'safety-net' modulation rate[47] are considered when deciding the amount of an advance. This information is captured within the IPMS, and enables DIISR to reduce advance payments to avoid the likelihood of scheme debt. For Program Year 2, five debts were identified by the department, which totalled around $334 000 and which is significantly less than the total amount for Program Year 1. Three of these debts resulted from entities receiving more in advance payments than they were entitled to when their final payment was determined. The two remaining debts resulted from entities being paid an advance, but were not eligible to make a claim.

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47 This rate is set marginally below the forecast modulation rate for the Program Year.

4.25 The measures implemented by DIISR are designed to reduce the likelihood of, but not eliminate, scheme debts. This is because debts can arise through other circumstances, which are not specifically addressed through the amendments to the Scheme or AusIndustry's new processes. These include failing to notify the department of the disposal of plant and equipment; not applying for a transfer of registration following the sale of a business or when a corporate restructure takes place; and non-compliance identified through compliance activities.

Funding and recovery of Scheme debts

4.26 The department's decision to modulate grant payments on an 'accruals basis'[48] meant that it had to find an additional source of funding for debts for Program Year 1 (and potentially beyond). The reasons for this were:

- the 50 advance payments, which became scheme debts, were not included in the modulation process—as the department determined that the annual appropriation of $97.5 million should be used only to pay advances and grants, not to cover scheme debts;
- the 50 advance payments had originally been paid out of the annual funding limit of $97.5 million; accordingly, this had reduced the annual appropriation to around $96 million;
- none of the debts were repaid in time to allow them to be included in the disbursement of funds for Program Year 1; as a result, there was a cash shortfall of $1.51 million in the annual appropriation for the Scheme.

4.27 For Program Year 1, the department obtained approval in May 2007 from the then Minister for Industry, Tourism and Resources to re-allocate $1.51 million in savings from another program also administered by DIISR to the Scheme. In seeking the Minister's approval to reallocate funds, the department relied on advice from the then Department of Finance and Administration[49] that it was acceptable to fund the cash shortfall from another program providing the program was also covered under Outcome 1 in the department's Portfolio Budget Statements, and the amount was less than $5 million. The reallocation of funds met both conditions.

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48 DIISR advised that this approach means that the funding available to be paid as grants to eligible entities excludes certain types of payments that became debts (for example, overpaid advances).

49 Now called the Department of Finance and Deregulation.

4.28 As of 30 June 2008, all 50 entities that had received overpaid advances had repaid their debts. Of the two remaining debts, which related to eligibility issues, one was repaid, and the other debt remains outstanding ($219 000). In the end, DIISR used $1.23 million in funding from the other program to cover these payments. It advised that the balance of the $1.51 million taken from the other program ($280 000) has been returned to consolidated revenue.

Ongoing implications of debt management

4.29 The implications of DIISR's decision to obtain funds outside of the annual allocation for the Scheme include having to find similar funding arrangements, where debts arise in later years of the Scheme; and developing additional functionality within IPMS to track the amount of money coming from the other appropriation. This approach also has implications on how the use of these funds will be reported publicly, for the benefit of Parliament and other interested stakeholders. A more sustainable model for managing the Scheme's debts could be considered by DIISR in the context of its annual budgeting process, or if any changes are made to the program's funding arrangement.

Conclusion

4.30 For the 2005–06 and 2006–07 Program Years, DIISR paid out $96.1 million and $97.4 million respectively in cash entitlements to entities from the TCF industry. A further $381.5 million in funding is available to eligible entities over the remaining years of the Scheme until 2014–15.

4.31 The calculation of grants is seen as a significant risk by the department. Consequently, a number of precautionary measures were taken to gain assurance that the payment system for the Scheme was robust and reliable prior to Program Year 1. The ANAO confirmed that DIISR has implemented adequate application controls within the IPMS to calculate claims accurately and to adhere to funding limits, in accordance with legislative requirements. It has also taken appropriate measures to reduce the risk of debts occurring, as happened in the first year of the Scheme. Nevertheless, the decision to obtain funds from a separate appropriation creates ongoing monitoring, management and reporting issues for the department.

5. Governance and Effectiveness

This chapter examines the department's governance arrangements for the Scheme, and its approach to evaluating and reporting on whether the statutory objective of the Scheme is being achieved.

Introduction

5.1 In the three previous chapters, the ANAO assessed whether key aspects of the Scheme—eligibility, claim assessment and grant payments—are being administered effectively by AusIndustry. This chapter considers the broader program management issues of whether the department has:

- established sound governance arrangements to support the delivery of the Scheme (covering areas such as planning, risk management, roles and responsibilities, delegations, internal review and oversight); and
- evaluated and reported on whether the Scheme is achieving its statutory objective of fostering the development of a sustainable and internationally competitive TCF industry in Australia.

Governance framework for the Scheme

5.2 As previously noted, the Scheme is administered jointly within DIISR by AusIndustry and the Manufacturing division. This approach is in line with the department's arrangements for administering other industry programs. Key staff from both divisions have been involved in delivering the Scheme and the previous TCF SIP Scheme.

5.3 The Scheme is subject to similar governance arrangements that apply to other programs delivered within DIISR. Key elements of this framework are:

- *Planning and risk management*—AusIndustry, in consultation with the Manufacturing division, produces an annual product plan for the Scheme that outlines planned outcomes and sets financial, compliance and service delivery targets. The product plan is accompanied by a risk management summary, which identifies program-specific risks and risk mitigation strategies;
- *Policies and procedures*—the department has produced an internal procedures manual for AusIndustry staff and has published a program

guide for customers, which is available on its website and was last updated in February 2008;

- *Delegations and authorisations*—the Secretary has delegated certain powers under the *Textile, Clothing and Footwear Strategic Investment Program Act 1999* (the Act) to a number of senior officers responsible for administering the Scheme. In practice, most powers are exercised by the product manager in AusIndustry;
- *Internal reporting and executive oversight*—a monthly performance report is provided to an executive committee within AusIndustry. The report covers financial management, service delivery, compliance issues, legal and sensitive cases and data quality. Key issues from these reports are incorporated into a department-wide 'traffic light' report, which considers the progress, and risks, of programs;
- *Stakeholder management*—DIISR undertakes annual customer satisfaction surveys, which cover a range of programs delivered by AusIndustry, including the Scheme. Program-specific surveys are also undertaken on a cyclical basis. The TCF SIP Scheme was covered in 2002, while a survey on the current Scheme is yet to be scheduled; and
- *Internal review*—there have been several internal audits of the Scheme and the TCF SIP Scheme. The most recent audit was completed in September 2006. It examined governance and risk management arrangements for the Scheme.

5.4 The ANAO confirmed that each of these elements was in place during Program Year 1, and they continue to be part of DIISR's governance framework for the Scheme. However, as outlined in Chapter 4, two program management issues emerged during the implementation phase of the Scheme that highlighted a lack of clarity around decision-making responsibilities and the absence of timely issue resolution processes. In summary, these issues involved a lack of agreement between the policy and service delivery divisions on the appropriate basis of modulating grant payments for Program Year 1 (and beyond); and, related to this, the need to manage the $1.51 million in debts that arose that year.

5.5 The lack of agreement between the divisions came down to different interpretations of the legislation, which happens from time to time. However, this issue took around eight months to resolve, and resulted in AusIndustry being formally 'directed' by the Manufacturing division to develop the modulation calculator on an 'accruals' basis, in accordance with its interpretation of the Scheme.

5.6 The lack of agreement put pressure on the eBusiness division to finalise the payment system. It also meant that the consultant originally engaged by AusIndustry to review the cash-based system had to be re-engaged to review the accrual system mandated by the Manufacturing division—an additional cost to DIISR. As well, there was insufficient visibility and timely escalation of the issue to DIISR's executive, which contributed to this issue not being resolved in a timely manner. Ultimately, however, changes to the IPMS were completed on time to meet the grant payment deadline of 10 June 2007, and better processes are now in place to minimise the risk of debts occurring (as discussed in Chapter 4).

Evaluating and reporting on the effectiveness of the Scheme

5.7 The Scheme is the largest component of the $747 million assistance package for the TCF industry. It provides up to $575 million in entitlements to eligible TCF entities over the period 2005–06 to 2014–15, and it follows on from the TCF SIP Scheme, which provided $641 million in benefits to eligible entities. The statutory objective of the Scheme is to foster the development of a sustainable and internationally competitive TCF manufacturing industry and TCF design industry in Australia by providing incentives that will promote investment and innovation.[50]

5.8 In light of this objective, and the substantial taxpayer funding available to the TCF industry, it is expected that DIISR would have arrangements in place to measure and report publicly on whether the Scheme is:

- effective in promoting investment and innovation in the industry—the more immediate policy objective of the Scheme; and
- helping to foster the development of a sustainable and internationally competitive TCF industry in Australia—the longer-term policy objective of the Scheme.

Such arrangements would be consistent with the principles of good program management, and enhance the transparency of the largest budgetary assistance measure for the TCF industry.

50 Sub-section 37A(1) of the *Textile, Clothing and Footwear Strategic Investment Program Act 1999*.

Outcome and outputs framework

5.9 Since the Scheme commenced in 2005–06, it has fallen under Outcome 1 of the department's outcome and outputs framework. However, following a change to the Administrative Arrangements Order, which came into effect on 3 December 2007 (following the change of government), the outcome, output group and key performance indicators have been amended. A comparison of the current and previous reporting framework is provided in Table 5.1.

Table 5.1

Comparison of the outcome, outputs and key performance indicators for the TCF Post-2005 (SIP) Scheme, for the period 2005–06 to 2008–09

Previous framework	Current framework
Outcome 1 A stronger, sustainable and internationally competitive Australian industry, comprising the manufacturing, resources and services sector.	Outcome 1 Improve the economic viability and competitive advantage of Australian Industry, including the manufacturing and services sectors, through the delivery of initiatives to address impediments to market development and encourage the take up of innovation within those sectors.
Output Group 1.1: Program Management Services This output group covered programs delivered by AusIndustry, the department's program delivery division.	Output Group 1: Industry Sectoral policy advice and the implementation and delivery of effective programs in areas such as automotive; textile, clothing and footwear; pharmaceuticals; engineering; building; aerospace; and the information and communications technology sectors.
Performance indicators Based on quantity, quality and price. • In 2005–06, the department reported that 338 TCF customers were assisted and benefits of $128 million were provided. Customer satisfaction with service delivery by AusIndustry as a whole was reported as 90.8 per cent.	Performance indicators The amount of TCF investment in new plant and equipment and innovation. • The associated performance target for 2008–09 is expenditure in excess of $110 million on plant and equipment and expenditure in excess of $70 million on innovation.

Source: Portfolio Budget Statements for the (former) Department of Industry, Tourism and Resources and the Department of Innovation, Industry, Science and Research

5.10 A key difference between the reporting frameworks is that DIISR has now included a performance indicator, and an associated performance target, to measure the increase in investment in plant and equipment and innovation. The 2008–09 expenditure target of $110 million on plant and equipment and $70 million on innovation relate to entities' expenditure on these activities in the first year of the TCF SIP Scheme, 2000–01. This baseline provides a means to measure increases in entities' investment, and to determine whether there has been an increase in investment over time. However, it does not measure whether this increase is a direct result of the Scheme, or whether the investment would have occurred in any case.

5.11 As discussed below, DIISR has relied on two external reviews of the industry to analyse whether the Scheme and its predecessor, the TCF SIP Scheme, have been beneficial for the industry and have contributed towards the desired policy outcomes.

External reviews of the TCF industry

5.12 The first external review took place in 2002 during the second year of the TCF SIP Scheme. It was conducted by the Productivity Commission, at the request of the then Treasurer. The scope of the inquiry was to evaluate the TCF assistance package that commenced in 2000 and to assess the long-term viability and opportunities for the industry. The key points from the Commission's report included:

- major structural change has occurred in the Australian textile, clothing, footwear and leather (TCF) industries, mainly in response to global competitive pressures affecting producers in all developed countries;
- even so, some Australian TCF producers are internationally competitive. Others have the capacity to become so, particularly if impediments and weaknesses that reduce viability can be addressed;
- the current tariff pause and transitional budgetary support have helped some firms to improve their international competitiveness and long term viability. However, this special assistance treatment is costly for others in the community and cannot continue indefinitely; and
- to facilitate adjustment to these tariff reductions, the Commission proposes that transitional budgetary support be extended for a further eight years from 2005, but with funding levels reducing over time.

> Such support should be delivered using a modified version of the current Strategic Investment Program.[51]

The Commission's inquiry informed the Government's policy settings for the current $747 million assistance package for the TCF industry.

Review of the TCF industry – 2008

5.13 In March 2008, the Australian Government announced a further review of the TCF industry, to be conducted by an independent review panel headed by Professor Roy Green.[52] The Terms of Reference for the review include an assessment of the appropriateness and effectiveness of the assistance measures provided to the industry, including the Scheme.

5.14 As part of the review, the Government separately requested the Productivity Commission to undertake modelling of the economy-wide effects of future assistance options for the TCF industry. The Commission reported its findings in June 2008. In summary, its modelling indicated that:

> there would be economy-wide benefits from further reductions in the relatively high tariffs on TCF imports. Assistance reductions would involve some further contraction of the TCF sector, but this would be outweighed by expansion of other industries resulting from cost reductions. Consumers and taxpayers would benefit from a reduction in the $1.5 billion burden they currently bear.[53]

5.15 Professor Green's report was provided to the Minister on 29 August 2008. It included an evaluation of the six programs comprising the 2005–2015 assistance package for the TCF industry. For the Scheme, the review found that there were two issues that act as impediments to its effectiveness. The first is modulation, which reduces the size of the final grant provided to entities and was found to undermine their confidence in making investment decisions. The second was the lack of Type 2 grant assistance for the technical textiles and leather sector, which reduces the incentive to undertake innovative activities.[54]

5.16 The report did not comment directly on whether the Scheme is achieving its statutory objective of making the industry more sustainable and internationally competitive. However, it concluded that the current Scheme

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51 Productivity Commission 2003, *Review of TCF Assistance*, Report No. 26, Canberra, p.XIV.

52 Dean of the Macquarie Graduate School of Management.

53 Productivity Commission, Media Release 8 July 2008, 'Modelling TCF Assistance'.

54 Green, R. 2008, *Building Innovative Capability: Review of the Australian Textile, Clothing and Footwear Industries*, Commonwealth of Australia, p. 58.

and the previous TCF SIP Scheme have made a positive contribution to Australia's TCF industries, helping entities to reposition themselves to compete in the changing business environment.[55] Among the 15 recommendations made in the report, Professor Green proposed that a new TCF innovation assistance package be introduced for the period 2009–2015, with a budget of $250 million. The aim of this package would be to focus on building innovative capability at the level of the enterprise and the workplace.

Intermediate outcomes of the Scheme

5.17 Although the department collects a range of industry data, it has not developed the necessary key performance indicators to determine the impact of the Scheme on the TCF industry. That is, whether the assistance provided under the Scheme has assisted the industry to be more sustainable and internationally competitive, in line with the statutory objective. This is particularly relevant given the changes to the assistance offered after 2009–10, either under the Scheme or any new assistance package adopted by the Government in response to Professor Green's review.

5.18 To enhance its performance management framework, the ANAO considers that DIISR could develop and report against intermediate outcomes for the Scheme, as it does for the Automotive Competitiveness and Investment Scheme, another large industry assistance scheme it administers. For ACIS, the department developed key performance indicators and prepared an intermediate outcome performance report.[56] This approach would provide a suitable model for the Scheme, and could consider the following three suggested intermediate outcomes:

- sustainable growth of the TCF manufacturing and design sectors;
- improved international competitiveness of products made by the TCF industry; and
- increased investment and innovation within the TCF industry.

A precursor to any such analysis would be to define what is meant by 'sustainable' and 'internationally competitive'.

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55 ibid, p. 62.

56 ANAO Performance Audit Report No. 19 2007–08, *Administration of the Automotive Competitiveness and Investment Scheme*, pp. 66–70.

Public reporting on the Scheme

5.19 DIISR's public reporting on the Scheme has been limited to the outputs of the Scheme — that is, information on the number of customers assisted and the amount of grant funding provided. Also, in accordance with the Act, the Minister published a list of grant recipients for Program Year 1. The list was published in May 2008 and is available on the department's website at www.ausindustry.gov.au.

Conclusion

5.20 DIISR has established the main elements of a governance framework to manage and oversee the delivery of the Scheme. However, in light of the issues experienced in Program Year 1, the relationship between the policy and service delivery divisions could be strengthened, to better support the ongoing delivery of the Scheme.

5.21 External reviews of the TCF industry in 2002 and in 2008 have examined the effectiveness of government support measures, including the Scheme and the TCF SIP Scheme. The reviews have also informed policy settings for the industry. DIISR has recently developed a KPI to measure whether there has been an increase in the level of investment in plant and equipment and innovation in the TCF industry. However, although the department collects a range of industry data, it has not developed the necessary key performance indicators to determine the impact of the Scheme on the TCF industry, and the longer-term policy objective of making the industry more sustainable and internationally competitive.

Recommendation No.2

5.22 The ANAO recommends that the Department of Innovation, Industry, Science and Research enhance its performance management framework for the Textile, Clothing and Footwear Post-2005 (SIP) Scheme by:

(a) developing intermediate outcomes for the Scheme and appropriate performance measures; and

(b) reporting progress against these outcomes annually (or as reliable data becomes available).

Department's response

5.23 Agreed.

Ian McPhee

Auditor-General

Canberra ACT

2 December 2008

Appendices

Appendix 1: DIISR's Full Response to this Audit

Secretary

Australian Government
Department of Innovation
Industry, Science and Research

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Mr M Cahill
Group Executive Director
Performance Audit Services Group
GPO Box 707
CANBERRA ACT 2601

Dear Mr Cahill

I refer to your letter of 14 October 2008, concerning the Australian National Audit Office (ANAO) draft report on the Administration of the Textile, Clothing and Footwear Post-2005 (SIP) Scheme.

The Department accepts the two recommendations to enhance the compliance management strategy and the performance management framework of the TCF Post-2005 (SIP) Scheme and acknowledges that their adoption will strengthen the transparency and delivery of the program.

In accordance with the format laid out in your 14 October letter, the Department's responses to the report are provided at Attachment A.

I acknowledge the ANAO's cooperation during the audit and the assistance provided to the Department.

Should you have any questions in relation to this response, please contact Mr Paul Sexton, General Manager Customer Services, AusIndustry on 03 9268 7500.

Yours sincerely

Mark Paterson

Mark I Paterson AO

7 November 2008

ATTACHMENT A

1. Department's Full Response to the Audit

The Department welcomes the ANAO's conclusion that the Scheme is being administered effectively, with sound processes and controls in place to assess eligibility of entities to receive assistance and for calculating and paying grants within the funding limits of the Scheme. (18) In addition, the ANAO has indicated that the current assessment process is well documented and timely. (3.29) The Department notes the ANAO's confirmation that appropriate measures have been taken to reduce the risk of debts occurring following the first year of the Scheme. (4.31)

The Department has a broad compliance management strategy to manage the risks associated with the administration of the Scheme. These include desk-based assessments, independent auditor's reports verifying expenditure, site visits and compliance appraisal program visits. The ANAO notes that together these processes provide coverage of all claims and enable key aspects of claims to be verified. (3.29)

The ANAO supports the Department's move to self assessment and sees this as an opportunity to enhance aspects of its compliance management strategy. Consequently, the Department will refine the current risk management strategy to rebalance the site visits program to target higher-risk entities during the claim assessments period. The ANAO indicated that the Department's current risk assessment process is rigorous, and accordingly this tool will continue to be used as a basis for selecting entities for site visits.

Given the Department's move to greater use of the self assessment provisions of the Scheme, the Department acknowledges the ANAO's view that additional guidance should be provided to entities on types of activities not supported. Additional information will be provided via newsletters and the website. The Department also agrees to an annual review and update of guidance material.

The ANAO notes that a review of the TCF industry found that both the current and previous TCF SIP schemes have made a positive contribution to Australia's TCF industry. (21) The Department will build on the outcome of the comprehensive survey of the TCF SIP grantees undertaken by the Workplace Research Centre as part of the Review of the Australian TCF Industries to put in place appropriate intermediate performance measures for the TCF Post-2005 (SIP) Scheme and report against these outcomes as reliable data becomes available.

2. A Response to each of the Recommendations

Recommendation No. 1
To enhance the compliance management strategy for the Textile, Clothing and Footwear Post-2005 (SIP) Scheme, the ANAO recommends that the Department of Innovation, Industry, Science and Research:

(a) refine its program of site visits, to target higher-risk entities during the 60-day claim assessment period;

(b) provide additional feedback to entities on the types of claims that are not supported, to minimise the risk of mis-claiming in the following Program Year(s); and

(c) regularly review and, where necessary, update guidance material for scheme participants.

Department Response
Agreed.

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Recommendation No. 2
The ANAO recommends that the Department of Innovation, Industry Science and Research enhance its performance management framework for the Textile, Clothing and Footwear Post-2005 (SIP) Scheme by:

a) developing intermediate outcomes for the Scheme and appropriate performance measures; and
b) reporting progress against these outcomes annually (or as reliable data becomes available).

Department Response
Agreed.

Appendix 2: TCF Assistance Package – 2005 to 2015

Table A 1

Summary of the 2005–2015 TCF Industry Assistance Package

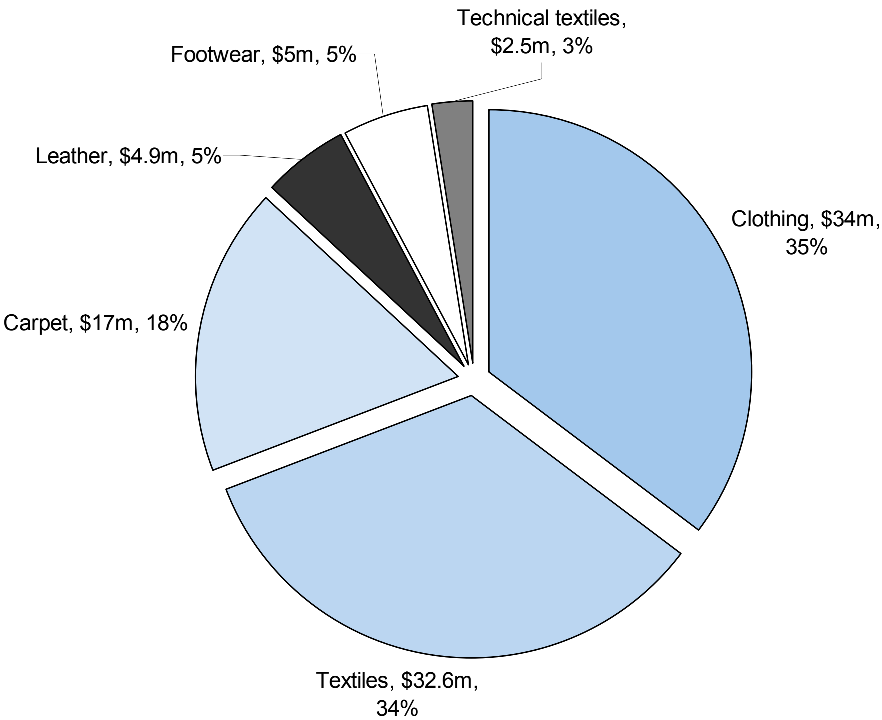
Assistance measure	Objective	Timeframe and funding	Delivered by
TCF Small Business Program	A ten-year competitive grants program, which aims to improve the business enterprise culture of TCF small businesses unable to receive assistance under the TCF Post-2005 (SIP) Scheme.	• 2005–06 to 2015–16 • $2.5 million per annum	AusIndustry
Product Diversification Scheme	This Scheme is designed to assist clothing and finished textile manufacturers and designers located in Australia internationalise their sourcing arrangements and complement their product range. It provides duty credit that can be used to offset duty payable on qualifying finished clothing or relevant finished textile articles.	• 2005–06 to 2016 • $5 million per annum in duty credits • Capped at $50 million	AusIndustry and the Australian Customs Service
Structural Adjustment Program	To encourage restructuring and to reduce the burden of transition experienced by firms, workers and communities, particularly in TCF-dependent regions.	• 2005–06 to 2015–16 • Capped at $50 million	DIISR's Manufacturing division, along with DEEWR and DITRD&LG
Expanded Overseas Assembly Provisions Scheme	This scheme allows registered TCF manufacturing or design firms, who use predominantly Australian fabric or leather, to assemble certain apparel and footwear articles overseas. The assembled goods can then be brought back into Australia for local consumption with duty payable only on the cost of the overseas processing and content.	• Capped at $27 million	Customs on behalf of DIISR. But, AusIndustry registers companies
Supply Chain Opportunities Program	No details yet available.	• Due to start in 2010 • Capped at $20 million	Not yet assigned

Source: ANAO based on data provided by the Department of Innovation, Industry, Science and Research

Appendix 3: Breakdown of Grant Payments for Program Year 1, 2005–06, of the TCF Post-2005 (SIP) Scheme

Figure A 1

Breakdown of grant payments for Program Year 1, by industry sector



Note: Rounding to one decimal place has been used for the figures in this graph

Source: ANAO based on data provided by the Department of Innovation, Industry, Science and Research

Appendix 4: Payment Factors for the TCF Post-2005 (SIP) Scheme

Table A 2

Payment factors for the TCF Post-2005 (SIP) Scheme

Payment factor	Description
Funding limits	
Grants types	• Type 1 grants must not exceed 40 per cent of eligible investment on new plant and equipment and brand support • Type 2 grants must not exceed 80 per cent of eligible investment on research and development and innovation activities
Advances	• Must not exceed 20 per cent of eligible expenditure for Type 1 grants • Must not exceed 40 per cent of eligible expenditure for Type 2 grants • Advances are not subject to sales-capping or modulation
Maximum expenditure amounts for certain Type 1 activities	• $2 million per annum in relation to the acquisition or development of new computer hardware or software (available only to entities in the clothing and finished textile sectors) • $3 million per annum for trade showings and in-store promotion
Sales caps on individual grant payments	• Calculated at five per cent of the total eligible revenue in the previous income year • Calculated at 15 per cent for eligible start-up investment amounts for entities that qualify as start-ups
Annual funding limits for the Scheme	• $97.5 million in Program Year 1 • $97.5 million in subsequent Program Years, plus eligible carryover amounts • All grant payments are modulated if demand for funding exceeds the annual limit
Carry-over amounts	
Deferred grant eligibility amounts	• If an entity has invested in eligible activities, but has not exceeded the $200 000 threshold, the eligible grant amount (adjusted by modulation) is set aside to a subsequent Program Year until the threshold is passed • Deferred eligibility amounts are subject to modulation
Excess amounts	• If an entity has their entitlement capped by the five per cent sales cap, the excess eligible grant amount (adjusted by modulation) can be carried over to the next Program Year

Source: ANAO based on the *Textile, Clothing and Footwear Post-2005 Strategic Investment Program Scheme 2005*

Appendix 5: Summary of Grant Payments for Program Year 2, 2006–07, of the TCF Post-2005 (SIP) Scheme

Table A 3

Summary of grants paid out for Program Year 2, 2006–07

Type of payment	Description	No. of entities	Total $
Advances (a)	Amounts paid prior to determination of final grant entitlements	260	45 167 917
Final claims (b)	Final payments following the determination of claims (includes deferred eligibility grant amounts)	372	52 569 055
Total payments (c)	Advances (a) plus final claims (b)	374[1]	**97 736 972**
Deferred grant eligibility amounts (d)	Total funding related to deferred amounts from Program Years 1 and 2, excluding the amounts paid in final claims (b)	52	946 813
Scheme debts – partially acquitted advances (e)	Overpayments resulting from a difference between the final claim determination and the advance of a grant already paid	3	49 459
Scheme debts – unacquitted advances (f)	Overpayments resulting from advances that were paid (a) but not followed by an eligible claim, as required under the Scheme	2	284 964
Total Scheme debts (g)	Partially acquitted advances (e) plus unacquitted advances (f)	5	**334 423**
Total entitlements (h)	Total payments (c) minus total Scheme debts (g)	372	**97 402 550**
TOTAL FUNDING	Total entitlements (h) plus deferred eligibility amounts (d) plus unacquitted advances (f)	374	**98 634 329**

Note 1: The difference between final claims (b) and total payments (c) is due to two entities receiving an unacquitted advance (f) to which they were subsequently not entitled

Source: ANAO analysis of data provided by the Department of Innovation, Industry, Science and Research

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