

Approval and Administration of Commonwealth Funding for the East West Link Project

[Across Entities](#)

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Canberra ACT
14 December 2015

Dear Mr President
Dear Mr Speaker

The Australian National Audit Office has undertaken an independent performance audit Across Entities titled *Approval and Administration of Commonwealth Funding for the East West Link Project*. The audit was conducted in accordance with the authority contained in the *Auditor-General Act 1997*. Pursuant to Senate Standing Order 166 relating to the presentation of documents when the Senate is not sitting, I present the report of this audit to the Parliament.

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

Yours sincerely



Grant Hehir
Auditor-General

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

AUDITING FOR AUSTRALIA

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

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Summary and recommendations

Background

1. The East West Link project was one of the largest transport infrastructure projects proposed in Australia. The full project was to provide an east-west alternative to the Monash-Citylink-Westgate corridor and was to be delivered in two stages. The first (eastern) stage included a cross city road (including tunnels) connecting the Eastern Freeway to CityLink. The second (western) stage was to be from the Port of Melbourne precinct to the Western Ring Road at Sunshine West.
2. A \$1.5 billion Commonwealth contribution to the East West Link project was announced as a commitment by the Coalition during the 2013 Federal election campaign. As part of the 2014 Budget process, \$1.5 billion of Commonwealth funding for stage one of the East West Link was approved by the then Prime Minister. Also approved was a further \$1.5 billion for stage two, in response to funding requests made by the then Victorian state government in early 2014. On 30 June 2014, \$500 million of the stage one funding and \$1 billion of the stage two funding was paid to Victoria.
3. Support for the East West Link project was a point of difference between the major political parties in the lead up to the 29 November 2014 Victorian state election. On 12 December 2014, the incoming Victorian Government announced the immediate suspension of work on the East West Link project. Three days later the project's business cases and related documents were publicly released by the Premier. In February 2015, Victoria notified the Commonwealth of the project's cancellation. None of the Commonwealth funding paid in June 2014 had been spent. This funding has also not been returned to the Commonwealth.

Audit objective and criteria

4. The objective of the audit was to assess whether appropriate steps were taken to protect the Commonwealth's interests and obtain value for money in respect to the approval of \$3 billion in Commonwealth funding, and the June 2014 payment of \$1.5 billion of that funding. To form a conclusion against this audit objective, the ANAO adopted the following high-level audit criteria:
 - the decisions to approve the commitment of Commonwealth funding were informed by appropriate advice; and
 - the June 2014 payment of \$1.5 billion was informed by appropriate advice, with sound governance arrangements put in place by the Commonwealth in relation to these funds.

Overall conclusion

5. Neither stage of the East West Link project had proceeded fully through the processes that have been established to assess the merits of nationally significant infrastructure investments prior to the decisions by Government to approve \$3 billion in Commonwealth funding and to pay \$1.5 billion of that funding in 2013–14. This situation had been identified in departmental advice prior to the decisions being taken.

6. The Department of Infrastructure and Regional Development (DIRD) provided clear advice to Government that the \$1.5 billion was being paid in advance of project needs, and proposed an alternative payment approach that aligned payments with project progress.¹ The decision to provide \$1.5 billion in advance provided budget presentation benefits to the Government by bringing forward the payments which resulted in a larger budget deficit for 2013–14. None of the \$1.5 billion in advance payments had been spent by Victoria prior to the cancellation of the East West Link project. Interest earned on the advance payments to the end of October 2015 is estimated to have been more than \$49 million.

7. DIRD also provided timely advice to Ministers when it became evident that there was an increased risk that stage one may not proceed. This advice resulted in better management of the risks associated with the \$500 million advance payment for that stage being used for project cancellation costs.² No such action was able to be taken in respect to the \$1 billion advance payment made for stage two. This was because it was not possible to clearly specify the project scope in the approval documentation because significant project development work still needed to be undertaken in order for a business case to be prepared.

8. The non-legally binding nature of the agreements signed with the Victorian Government meant the Commonwealth was unable to rely on those documents to require the advance payments to be returned when the project was cancelled. In September 2015, the Department of the Treasury obtained legal advice on how Victoria could be required under the federal financial relations framework to repay the \$1.5 billion in advance payments. The advance payments had not, as of October 2015, been recovered from Victoria.

9. The ANAO has not made any recommendations in relation to entity advisory processes given the audit found that the funding decisions had been informed by well-considered departmental advice, and that Infrastructure Australia's assessment processes had been bypassed. The ANAO has made one recommendation to the Department of the Treasury for it to commence action under the federal financial relations framework to recover the advance payments from Victoria.

Supporting findings

Commonwealth funding for stage one (Chapter 2)

10. Following the September 2013 Federal election, the \$1.5 billion commitment to stage one was included in the Commonwealth's Infrastructure Investment Programme through typical decision-making processes. The inclusion of a project in this programme reflects a commitment to the objectives of the project but does not obviate the need for Ministerial approval of a specific project proposal to achieve those objectives.³

1 Similarly, the Department of the Prime Minister and Cabinet provided the then Prime Minister with advice on the merits of making advance payments in relation to the East West Link project, and the implications of such an approach more broadly in relation to infrastructure project decision-making.

2 The risk management approach involved varying the project approval instrument for stage one to more clearly set out the scope of the project that Commonwealth funding could be used for, and exclude Commonwealth funding from being used as payment for any penalties, legal costs or court ordered costs that may be incurred should stage one be delayed or cancelled.

3 Approval is required both under the land transport legislation and the financial management framework.

11. The approval of funding had been given by the then Prime Minister sometime between 7 May and 12 May 2014.⁴ The usual process for obtaining the required statutory approvals is for DIRD to brief the relevant Minister on its analysis of whether the proposal is in accordance with the legislated requirements⁵ prior to a project approval instrument being signed. That did not occur on this occasion. This reflected that, at the time the decision was taken:

- DIRD had only recently received a finalised Project Proposal Report for stage one from Victorian officials, and it had not yet analysed the material that had been provided; and
- Infrastructure Australia had unanswered questions from July 2013 about the underpinnings of the project's short form business case, and did not receive the full business case (which was dated 30 June 2013) until 7 July 2014.

12. The eastern section was the more advanced of the two stages of the East West Link project. Procurement of a consortium to construct, operate and maintain stage one had commenced in mid-2013 and three parties had been shortlisted in September 2013 to submit proposals. The procurement process had not concluded⁶ at the time the then Prime Minister made his decision, with Victoria's May 2014 budget papers outlining that construction was expected to commence in late 2014. Consistent with this situation, departmental advice was that:

- neither stage one, nor stage two, of the East West Link project required Commonwealth funding in 2013–14; and
- advance payments on or before 30 June 2014 would increase the deficit for 2013–14 but improve the reported position for later years.

Stage two funding (Chapter 3)

13. The Victorian Government had not included stage two of the East West Link project in its 2013 submission to Infrastructure Australia. Instead, by approaching the then Prime Minister directly in early 2014, the Victorian Government secured approval of \$1.5 billion in Commonwealth funding for the western section without this proposal having been presented to, or assessed by, Infrastructure Australia.⁷

14. Some summary information on stage two of the project had been provided by the Victorian Government in early 2014 when seeking Commonwealth funding. The summary information provided was insufficient to enable an informed assessment of the merits,

4 September 2015 legal advice to DIRD was that the approval had been given by the then Prime Minister in undated correspondence that was sent sometime between those two dates.

5 At that time, the *Nation Building Program (National Land Transport) Act 2009* (the land transport legislation) required that the Minister only approve projects where he or she was satisfied they were eligible for approval (which, for road projects, required that they be on the National Network) as well as being appropriate for approval (the matters that may be considered included the results of any assessment of the economic, environmental or social costs or benefits of the project). The then applicable financial management legislation required that approval of spending proposal only be given where the approver was satisfied, following reasonable inquiries, that the proposal represented an efficient, effective, economical and ethical use of public money.

6 On 29 September 2014, Victoria appointed a consortium called East West Connect to construct, operate and maintain stage one.

7 Victoria was informed that the funding commitment was contingent on the state submitting an updated business case for the project to Infrastructure Australia, and Ministerial consideration of Infrastructure Australia's analysis, but this condition was not reflected in the project governance documentation.

estimated costs and timeframe of stage two. But it did provide some insights that highlighted significant project development work still needed to be done before a full business case could be prepared.⁸

15. The Victorian Government did not require \$1 billion in 2013–14 from the Commonwealth for stage two, and the correspondence from the then Premier to the then Prime Minister had not sought a payment in 2013–14. Stage two work in 2013–14⁹ and 2014–15 was expected to be focused on preparing the full business case, site preparation, design work and planning approvals (with the latter expected to extend into 2015–16). While procurement activities and project delivery were envisaged to commence in 2015–16, total expenditure on stage two was not expected to reach \$1 billion until 2016–17. Nevertheless, an advance payment of \$1 billion for stage two (double the stage one payment) was made on 30 June 2014. Departmental advice to Ministers was that this payment was in advance of need. This advice further identified that an advance payment would increase the deficit for 2013–14, but improve the reported position for later years.

The governance arrangements for the Commonwealth funding (Chapter 4)

16. The Commonwealth funding for the East West Link project was governed by:

- the National Partnership Agreement for land transport infrastructure projects under the federal financial relations framework. The Victorian schedule to the October 2014 National Partnership Agreement¹⁰ included both stages of the East West Link project, although no stage two figures were able to be included for the total project cost, the state contribution or the total of any other contributions;
- an East West Link Memorandum of Understanding signed on 28 June 2014 by the then Prime Minister and the then Victorian Premier; and
- two project approval instruments signed under the land transport legislation on 16 June 2014 by the then Assistant Minister for Infrastructure and Regional Development. One related to the \$500 million advance payment for stage one with the second related to the \$1 billion advance payment for stage two.

17. As originally signed, the project approval instruments inadequately set out the works that Commonwealth funding could be used for, and any project costs that were not to be met from the Commonwealth funding. This situation reflected that specific information on the two stages of the project was not available at the time the advance payments were made.

18. Attendance at project steering committee meetings enabled DIRD to be aware of heightened risks that construction work may be delayed or not proceed, and to then take prompt action to have the instrument for stage one varied in October 2014 to manage those

8 For example, the material revealed that a lack of transport modelling had precluded detailed economic analysis being available and the cost estimates were only preliminary.

9 The only expenditure for 2013–14 identified in the summary information provided by Victoria involved \$4 million to commence preparation of the full business case.

10 An earlier National Partnership Agreement, which was in place when the advance payments were made, expired on 30 June 2014. The agreement, signed in October 2014, is to operate from 1 July 2014 to 30 June 2019.

risks.¹¹ Reflecting that construction work was still some way off, there was insufficient information available to allow the stage two instrument to also be varied.

19. The entire East West Link project was cancelled by the incoming Victorian Government, without any of the Commonwealth funding having been spent and with Victoria having earned significant interest on the advance payments. Recovery of the advance payments had not, as of October 2015, occurred.

Recommendations

Recommendation No.1 Para 4.16	<p>The ANAO recommends that, as a matter of priority given the significant amount of Commonwealth funding that is involved, the Department of the Treasury recommend to the Treasurer that he make a determination requiring the return of the \$1.5 billion paid to Victoria in relation to the East West Link project.</p> <p>Department of the Treasury response: <i>Agreed with qualifications.</i></p>
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Summary of entities' responses

20. The proposed audit report was provided to DIRD, Infrastructure Australia and the Departments of the Prime Minister and Cabinet; Finance; and the Treasury. The proposed report was also issued to the Minister for Infrastructure and Regional Development and the former Prime Minister; former Assistant Minister for Infrastructure and Regional Development; and former Treasurer.

21. Formal responses to the proposed audit report were received from DIRD, Infrastructure Australia and the Department of Finance. A summary of entities' responses are below, with the full responses provided at Appendix 1. In addition, the Department of the Treasury responded to the recommendation.

Department of Infrastructure and Regional Development

The Department of Infrastructure and Regional Development (the Department) notes the ANAO's positive findings in relation to the Department's timely, thorough and appropriate advice on, and administration of, Commonwealth funding for the proposed East West Link Project.

Infrastructure Australia

Infrastructure Australia notes the report and believes that it accurately reflects Infrastructure Australia's role in the analysis of the East West Link Project.

Department of Finance

The Department of Finance acknowledges the findings of this report and supports the recommendation.

11 The variation provided greater detail about the works by reflecting the project scope agreed during negotiations between the Victorian Government and the consortium that had been selected to design, construct and operate the Eastern section of the East West Link; and excluding Commonwealth funding from being used as payment for any penalties, legal costs or court ordered costs that may have been incurred from stage one being delayed or cancelled.

Audit Findings

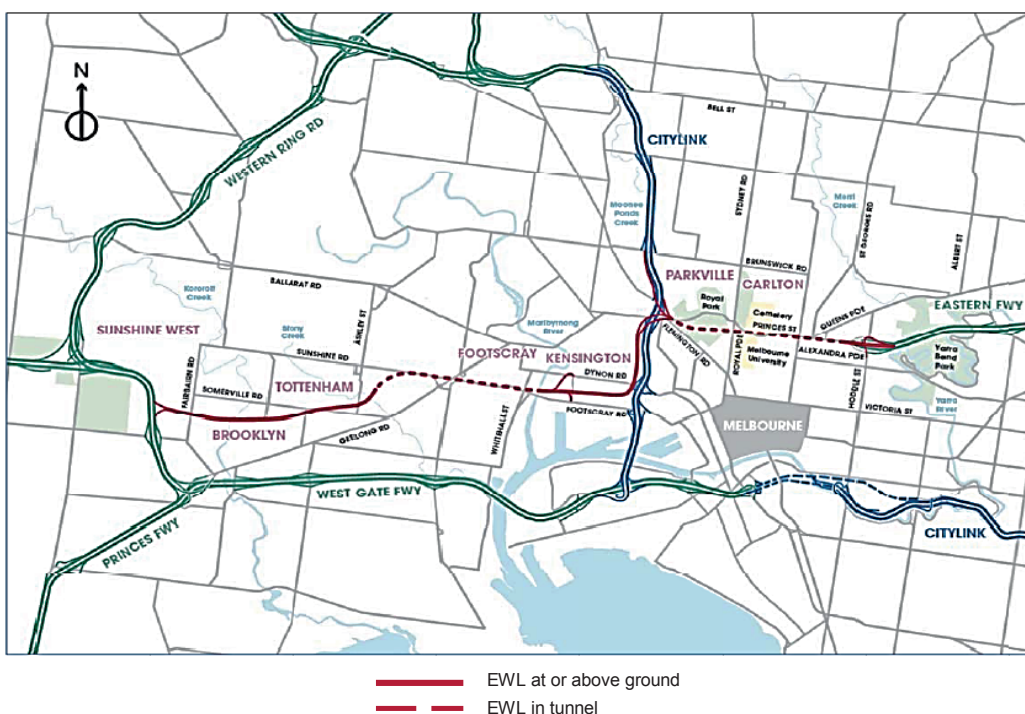
1. Background and context

The East West Link project

1.1 The East West Link was a proposed 18 kilometre cross city road connection, north of the Melbourne central business district, providing an east-west alternative to the Monash-Citylink-Westgate (M1) corridor. As illustrated by Figure 1.1, the project was to consist of an:

- eastern component (also referred to as stage one) from the Eastern Freeway to CityLink, including a connection from CityLink to the eastern side of the Port of Melbourne; and
- western component (also referred to as stage two) from the Port of Melbourne to the Western Ring Road.

Figure 1.1: Map of the East West Link



Source: 30 June 2013 project business case publicly released in December 2014.

1.2 The May 2014 Budget included \$1.5 billion in Commonwealth funding towards stage one of the East West Link, and a further \$1.5 billion for stage two (see Table 1.1). Of the \$1.5 billion commitment for stage two, \$1 billion was to be funded as part of an \$11.6 billion Infrastructure Growth Package announced in the May 2014 Budget. The intention was that this package would contribute to \$125 billion of additional infrastructure, including incentives to encourage asset recycling as a catalyst for unlocking significant new infrastructure investment. The budget papers outlined that, when completed, the construction projects supported through this package were expected to add around one percentage point to annual gross domestic product.

Table 1.1: Budgeted Commonwealth contributions

	13–14	14–15	15–16	16–17	17–18	18–19
Investment Programme – Road Projects						
East West Link—Stage one	\$500m	\$100m	\$300m	\$600m	0	0
East West Link—Stage two	0	0	0	0	0	\$500m
Infrastructure Growth Package – New Investments						
East West Link—Stage two	\$1000m	0	0	0	0	0
Total	\$1500m	\$100m	\$300m	\$600m	0	\$500m

Source: ANAO analysis of the Victorian schedule of projects to the National Partnership Agreement on Land Transport Infrastructure Projects as signed on behalf of the Commonwealth of Australia on 10 October 2014; and answers to questions on notice at the May 2014 Budget Estimates hearings.

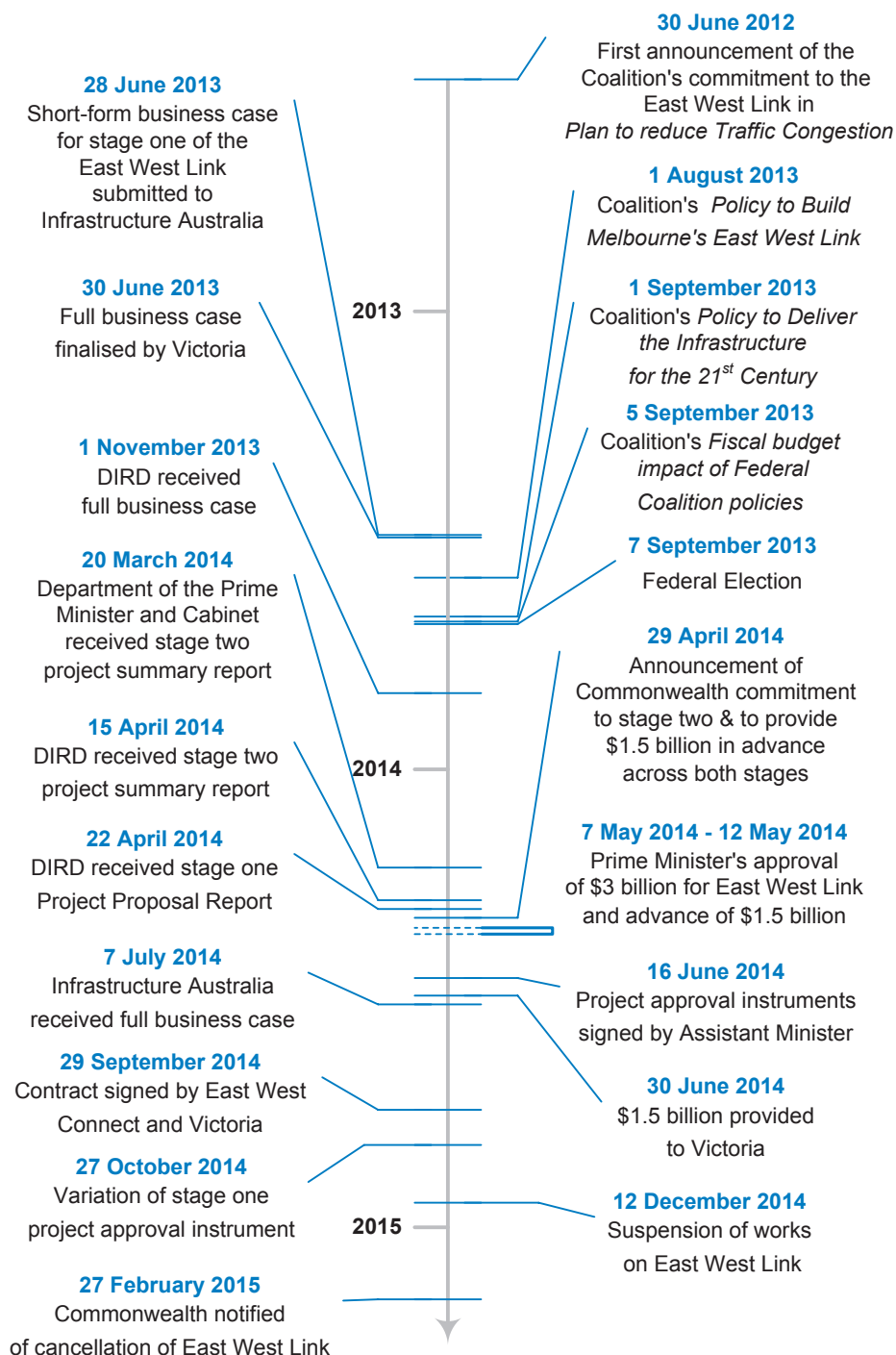
1.3 Of the \$3 billion total commitment to the East West Link project, the Budget identified that \$1.5 billion would be paid in 2013–14, comprising \$500 million for stage one and \$1 billion for stage two. To give effect to the decision that \$1.5 billion be paid in 2013–14:

- on 16 June 2014, the then Assistant Minister for Infrastructure and Regional Development signed two instruments approving Commonwealth Government funding under subsection 17(1) of the *Nation Building Program (National Land Transport) Act 2009* (the land transport legislation). Specifically, \$500 million was approved for stage one and \$1 billion for stage two; and
- on 27 June 2014, the then Treasurer signed a determination under the *Federal Financial Relations Act 2009* to enable an ‘extraordinary national partnership payment’ to be made on 30 June 2014, including \$1.5 billion in relation to the East West Link project.

1.4 Figure 1.2 provides an overview of key points in the decision-making process for the approval and payment of Commonwealth funding towards the East West Link project.

1.5 Following a tender process,¹² on 29 September 2014 Victoria appointed a consortium called East West Connect to construct, operate and maintain stage one. Consistent with its pre-election announcements, on 12 December 2014, the incoming Victorian Government announced the immediate suspension of works on the entire East West Link project. Three days later, the project’s business cases and related Victorian Cabinet documents from the former government were publicly released by the Premier. In February 2015, Victoria formally notified the Commonwealth of the project’s cancellation. In June 2015, the Victorian Government announced that it had reached agreement on a final settlement with the East West Connect consortium, formalising the in-principle settlement that had been reached in April 2015.

12 The three shortlisted tenderers had been announced in late September 2013, following an expression of interest process.

Figure 1.2: East West Link funding key events timeline

Source: ANAO analysis of entity records.

Infrastructure Australia's role in national infrastructure planning and decision-making

1.6 Infrastructure Australia was established in 2008 to improve the quality of infrastructure planning and investment strategy, and to identify those investments expected to make the biggest impact on Australia's economic, social and environmental goals for least cost to the taxpayer. Accordingly, it is a goal of Infrastructure Australia that infrastructure funding decisions will be taken following careful planning and rigorous assessments that are based on sufficient evidence.

1.7 Although originally established by the incoming Labor Government, Coalition policy has also supported the role of Infrastructure Australia. The Coalition's 2010 election infrastructure policy stated that it supported and would strengthen the role of Infrastructure Australia, and that it would choose to fund infrastructure projects that yield the highest net benefits. The Coalition's infrastructure policy document for the 2013 Federal election similarly stated that it fully supported Infrastructure Australia and proposed to reform its structure to focus the organisation on identifying:

- major projects that are of national significance; and
- economic and procurement reforms that are needed to allow Australia's governments to fund these projects.

1.8 A key role of Infrastructure Australia is to develop Infrastructure Priority Lists. The first such list was published in 2009. An ANAO audit of Infrastructure Australia's development of the first priority list¹³ concluded that the methodology used provided a robust framework which was reinforced by a rigorous approach to assessing candidate projects, including by:

- scrutinising the claims made by proponents in their submissions;
- seeking further information where it was needed; and
- engaging advisers to assist in deciding whether the benefit cost ratio submitted by a project proponent could be relied upon, or required moderation.¹⁴

1.9 The ANAO made three recommendations designed to provide greater transparency in the project prioritisation process and enhance the reporting of the prioritisation results. In this latter respect, the audit report had identified instances where decisions had been taken by the then Government to fund construction of infrastructure projects included on the priority list but prior to the project having been fully assessed by Infrastructure Australia, or where the economic merits of the project had not yet been demonstrated.

1.10 Subsequent to that audit report, Infrastructure Australia improved its reporting of prioritisation results. In particular, rather than the two categories used for the first priority list, four categories have been used in subsequent lists as follows:

- 'early stage'—addresses a nationally significant issue or problem, but the identification or development of the right solution is at an early stage;

13 ANAO Audit Report No.2 2010–11, *Conduct by Infrastructure Australia of the First National Infrastructure Audit and Development of the Infrastructure Priority List*, Canberra, 23 July 2010.

14 In particular, the analysis examined the robustness of the demand forecasts, the robustness of the proponent's costing, key methodological questions and benchmarked the figures used by the proponent.

- ‘real potential’—clearly addresses a nationally significant issue or problem and relevant options are being considered;
- ‘threshold’—proposals are well developed and present a detailed preferred option, or options. The initiative has strong strategic and economic merit and it is highly likely that the project will deliver economic benefits exceeding costs incurred; and
- ‘ready to proceed’—all of Infrastructure Australia’s criteria have been met such that they are priority infrastructure proposals that will deliver real economic benefits.

Audit objective, scope and criteria

1.11 The audit was undertaken following a request from the Hon Anthony Albanese MP, Shadow Minister for Infrastructure and Regional Development. In light of the matters raised, the objective of the audit was to assess whether appropriate steps were taken to protect the Commonwealth’s interests and obtain value for money in respect to the:

- approval of \$1.5 billion in Commonwealth funding for stage one of the East West Link project, and the June 2014 payment of \$500 million of this funding; and
- approval of \$1.5 billion in Commonwealth funding for stage two of the East West Link project, and the June 2014 payment of \$1 billion of this funding.

1.12 To form a conclusion against the objective, the ANAO adopted the following high level criteria:

- the decisions to approve the commitment of Commonwealth funding were informed by appropriate advice; and
- the June 2014 payment of \$1.5 billion was informed by appropriate advice, with sound governance arrangements put in place by the Commonwealth in relation to these funds.

1.13 The audit was conducted in accordance with ANAO auditing standards at a cost to the ANAO of \$476 557.

2. Approval of Commonwealth funding for stage one of the project

Areas examined

Stage one of the East West Link was the eastern section from the Eastern Freeway in Clifton Hill to CityLink in Parkville. A \$1.5 billion Commonwealth contribution to this project was announced as a commitment by the Coalition during the 2013 election campaign, with \$500 million of this earmarked to be paid in 2013–14 to accelerate construction work. The ANAO examined how the commitment made in the context of the 2013 election was progressed following the change in government, including the analysis and advice that informed decisions taken by Ministers in respect to this project.

Conclusion and findings

Following the election, the \$1.5 billion in stage one funding was added to the Infrastructure Investment Programme through typical decision-making processes. The inclusion of a project on this programme reflects the Commonwealth's commitment to the objectives of the project but does not obviate the need for Ministerial approval of a specific project proposal to achieve those objectives.

In the 2014 Budget context, \$1.5 billion of Commonwealth funding for stage one of the East West Link was approved, and \$500 million of this amount was paid in June 2014, before the project had proceeded through the processes established to assess the merits of nationally significant infrastructure investments. Of particular note was that:

- Infrastructure Australia had unanswered questions about the underpinnings of the project business case;
- the decision to make a \$500 million payment led to departmental due diligence on the project proposal not being completed. As a result, funding approvals were given under both the *Nation Building Program (National Land Transport) Act 2009* (the land transport legislation) and financial management framework but without there being any documented analysis and advice to Ministers that the statutory criteria for giving such approvals had been met; and
- the \$500 million payment was in advance of project cash flow needs.

What was the nature of the commitment to stage one and when was it announced?

A \$1.5 billion contribution to the cost of the eastern section was announced prior to the September 2013 Federal election. This commitment was made after Victoria had submitted the stage one proposal to Infrastructure Australia for assessment. Infrastructure Australia had unanswered questions about the underpinnings of the project business case.

2.1 On 30 June 2012, the then federal opposition released a document stating that if elected, it would work with the states and the private sector to ensure the acceleration of Melbourne's East West Link by providing a \$1.5 billion Commonwealth contribution as part of its Plan to Reduce Traffic Congestion. The release further stated that the:

- timing of payments for specific projects would depend on construction progress and would be developed in consultation with the state governments; and
- first year of funding for the *Plan to Reduce Traffic Congestion* would be 2014–15.

2.2 A commitment of this magnitude, for construction, was a substantial advance on the then most recent submission made by the Victorian Government to Infrastructure Australia. Specifically, the Victorian Government had in November 2011 sought \$30 million in project development funding for planning the eastern component of the project to identify preferred alignments; preparing a business case for the East West Link corridor; and finalising statutory approvals. An estimate of the capital cost of the project (which was broader in scope to the 2010 proposal that had been previously submitted to Infrastructure Australia) was not provided, nor was a benefit cost ratio (BCR). Infrastructure Australia's June 2012 priority list included this proposal as one of 29 assessed to have 'real potential', but (similar to the other 28 projects in that category) it was not considered to have yet demonstrated strong strategic and economic merit. Infrastructure Australia supported the request for \$30 million in project development funding.

2.3 Infrastructure Australia's June 2013 update to the priority list was prepared on the basis of an August 2012 submission from the Victorian Government. Infrastructure Australia assessed that the information provided in respect to the East West Link project was largely unchanged from the 2011 submission. Infrastructure Australia decided to retain the project in the 'real potential' category until additional information was made available (such as a business case including economic analysis and a cost estimate). Infrastructure Australia also continued to recommend the project receive development funding.

2.4 On 28 June 2013, after the June 2013 update to the priority list had been finalised, the Victorian Government provided an updated submission to Infrastructure Australia on the East West Link project. This submission was in the form of populated Infrastructure Australia templates and a short form business case that sought \$1.5 billion in Commonwealth funding towards the estimated \$6 billion to \$8 billion cost of the eastern link (stage one) and a number of other substantial upgrades to existing freeways. The submission stated that the BCR for the project was 1.4 including estimated wider economic benefits (WEBs) and 0.8 excluding WEBs. Infrastructure Australia's analysis¹⁵ was that:

It is not possible to assess the validity of this assessment at this stage given the documentation provided. However, it is unusual for wider economic benefits to be as high relative to standard benefits as has been derived for the project.¹⁶

No information has been provided on the number of vehicles using the new motorway at this stage, or the implications of alternative tolling arrangements.

2.5 On the basis of its analysis, Infrastructure Australia wrote to the Victorian Government in mid-July 2013 seeking further information on the project. Specifically:

- 'documents which clearly articulate the solution and the exact nature of the works that has been used in subsequent analysis';

¹⁵ The assessment was prepared by staff of Infrastructure Australia and was marked as 'draft'.

¹⁶ For example, Infrastructure Australia identified that the BCR calculated for the project included benefits in terms of reduced air pollution when it would have been expected that the project would increase the use of cars and therefore increase rather than reduce emissions.

- ‘details of the specific works for which costs have been estimated’, an estimate for each part of the project and identification of cost items or categories (such as land purchase, contingency and profit);
- a demand modelling study that, among other matters, identifies changes in travel time for major routes, the number and composition of users of the tunnel and the tolling regime that had been modelled;
- an economic appraisal study; and
- a staging document for the multiple components of the project.

2.6 A substantive response to this information request was not provided to Infrastructure Australia.¹⁷ Of note was that a full business case had been prepared but was not provided to Infrastructure Australia for analysis. A full business case dated 30 June 2013 and comprising 223 pages plus a further 18 attachments, including an economic analysis report and strategic traffic modelling report, was provided to the Department of Infrastructure and Regional Development (DIRD) on 1 November 2013. Infrastructure Australia did not receive a copy of this business case until 7 July 2014. In October 2014, DIRD advised the ANAO that:

Earlier business cases, including one dated 22 March 2013 in which the stated benefit cost ratio was 0.45, were not provided to either DIRD or Infrastructure Australia. This first came to the department’s attention when, on 15 December 2014, the current Victorian Government published a number of documents relating to the project.

2013 election campaign announcements

2.7 The policies released by the Coalition in the context of the 2013 Federal election campaign included a commitment to the East West Link project. Specifically, the:

- August 2013 *Policy to Build Melbourne’s East West Link* committed \$1.5 billion to the East West Link, on the basis that:
 - Infrastructure Australia supports the project with the associated discussion reflecting the project being included in the ‘real potential’ category (rather than in either the ‘threshold’ or ‘ready to proceed’ categories);
 - the Victorian Government’s business case had demonstrated that the project would provide \$1.40 in benefits for every \$1 spent on the project; and
 - construction will be underway in 2014, and expected to be completed by 2019–20;
- September 2013 *Policy to Deliver the Infrastructure for the 21st Century*, which restated the \$1.5 billion commitment to the East West Link project; and
- September 2013 *Fiscal budget impact of Federal Coalition policies* set out the project profiles and expected timing of Commonwealth funding for election commitments,

17 In November 2013, the Infrastructure Australia Council was advised that ‘the Office of the Infrastructure Coordinator has subsequently sought to progress its request [for further information], but despite a number of positive discussions, has not obtained any further information.’

including a payment of \$500 million (of a total of \$1.5 billion) for provision to Victoria in 2013–14 for the first stage of the East West Link.

Did sound analysis inform the decision to make a \$500 million payment for stage one in 2013–14?

Well-considered advice was provided to Ministers. The advice identified that stage one of the East West Link project had not proceeded fully through the processes that have been established to assess the merits of nationally significant infrastructure investments. The advice also identified that the project did not require a Commonwealth funding contribution to be paid in 2013–14.

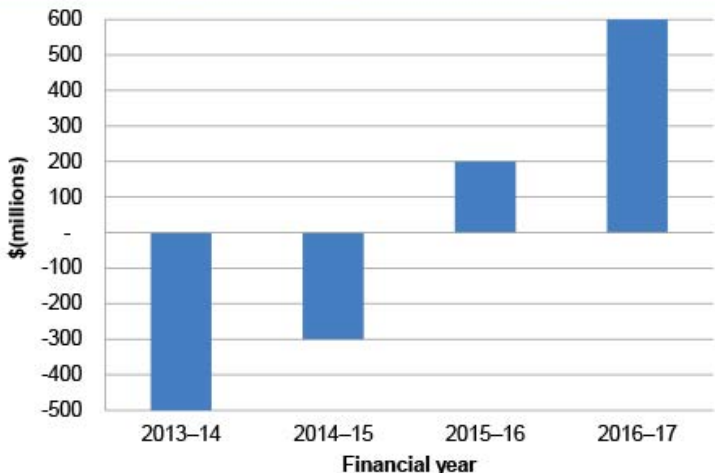
2.8 In November 2013, Ministers agreed the list of projects to be funded through the Infrastructure Investment Programme as well as the total funding envelope for the programme. Stage one of the East West Link project was included in the list of projects to be funded.

2.9 The Coalition's 2013 election costings had indicated an intention that the \$1.5 billion in Commonwealth funding announced for stage one of the East West Link project be front-loaded. The ANAO's analysis was that DIRD provided well-considered advice to its Ministers on a recommended funding profile for stage one of the East West Link and other projects that were the subject of election commitments. For example, DIRD's advice:

- took into account the nature of the election commitment announcement, as well as the funding profile identified in the election costings;
- identified payment profiles that were 'best for project' in that they aligned payments with anticipated project progress (see Table 2.1). In particular, based on its analysis of information provided by the Victorian Government in respect to stage one of the East West Link project, DIRD identified that the project did not require any Commonwealth contribution in 2013–14;¹⁸ and
- addressed whether making advance payments in respect to the East West Link and certain other projects would compound the existing problem with some states already underspent on their current infrastructure programmes.

18 The Victorian Budget had included \$224 million for stage one in 2013–14.

Table 2.1: Alternative project funding profiles

	2013–14	2014–15	2015–16	2016–17										
Election costings	\$500m	\$600m	\$400m	Nil										
DIRD's preferred approach	Nil	\$300m	\$600m	\$600m										
Fiscal balance impact of the election costing approach compared with DIRD's 'best for project' analysis	 <table><caption>Fiscal balance impact data</caption><thead><tr><th>Financial year</th><th>Impact \$(millions)</th></tr></thead><tbody><tr><td>2013–14</td><td>-450</td></tr><tr><td>2014–15</td><td>-250</td></tr><tr><td>2015–16</td><td>200</td></tr><tr><td>2016–17</td><td>600</td></tr></tbody></table>				Financial year	Impact \$(millions)	2013–14	-450	2014–15	-250	2015–16	200	2016–17	600
Financial year	Impact \$(millions)													
2013–14	-450													
2014–15	-250													
2015–16	200													
2016–17	600													

Source: ANAO analysis of departmental records and the *Fiscal budget impact of Federal Coalition policies*.

2.10 Similarly, the Department of the Prime Minister and Cabinet provided the then Prime Minister with advice on the merits of making advance payments in relation to the East West Link project, and the implications of such an approach more broadly in relation to infrastructure project decision-making.

2.11 In finalising the May 2014 Budget, Ministers decided that \$500 million should be paid in 2013–14 to the Victorian Government in respect to stage one of the East West Link project. Decisions were also made as part of the budget process in relation to Commonwealth funding for stage two of the East West Link project. Specifically:

- on 20 April 2014, the Minister for Infrastructure and Regional Development wrote to the then Prime Minister proposing that the Commonwealth agree to certain in-principle amendments to the Infrastructure Investment Programme including:
 - an additional \$1 billion for stage two of the East West Link project 'contingent on work on the project being underway by the end of 2015'¹⁹; and
 - a further \$500 million payment for stage two of the East West Link project, funded from a reallocation within the Infrastructure Investment Programme;
- on 7 May 2014, Ministers agreed that the then Prime Minister, the Deputy Prime Minister (who is also the Minister for Infrastructure and Regional Development), the

¹⁹ However, this condition was not reflected in the project governance arrangements – see paragraphs 4.5 and 4.12.

then Treasurer and the Finance Minister would finalise by correspondence any outstanding issues required to settle the 2014–15 Budget;²⁰

- also on 7 May 2014, the then Treasurer wrote to the then Prime Minister seeking his agreement to the payment of \$1.5 billion to Victoria for the East West Link project. That letter indicated that the payment of \$1 billion had been agreed to by the National Infrastructure Committee of Cabinet and that the further \$500 million payment had been proposed by the Minister for Infrastructure and Regional Development in his letter of 20 April 2014;
- through an undated letter, the then Prime Minister responded to the then Treasurer agreeing to the proposals in his 7 May 2014 correspondence; and
- on 12 May 2014, Cabinet endorsed the decisions of the Expenditure Review Committee in relation to the 2014–15 Budget, and noted a number of letters, including the 7 May 2014 correspondence from the then Treasurer to the then Prime Minister and the then Prime Minister’s undated response.

Who approved funding for the project under the relevant financial management legislation?

Funding for stage one was approved by the then Prime Minister.

2.12 In March 2015, DIRD obtained legal advice on the approvals necessary for the June 2014 payments to have been made by the Commonwealth to Victoria for the purposes of the building of the East West Link. The advice to DIRD was that, before the arrangement to pay \$1.5 billion was entered into, an approver should have approved a spending proposal (in accordance with the requirements of the then applicable *Financial Management and Accountability Regulations 1997*, FMA Regulations). This approval was required in addition to the approval of the project under the land transport legislation, and the determination made under the federal financial relations framework.

2.13 The usual process for obtaining approval under the FMA Regulations in respect to Infrastructure Investment Programme projects is to include the required analysis of whether the spending proposal represented an efficient, effective and economical use of public money as part of the covering brief when seeking Ministerial approval of the project approval instruments required by the land transport legislation. That did not occur on this occasion, as DIRD was of the view that the necessary approval under the financial management framework had already been provided by Ministers.

2.14 In March 2015, and again in August 2015, DIRD obtained legal advice as to whether, and when, the approval required under the financial framework had been given in respect to the East West Link project payments. The concluded position of the department’s legal advisor was that:

- it was clear from the documentation that, by 7 May 2014, the quantum, recipient and purpose of the East West Link project payments had been sufficiently particularised such that there was a spending proposal that was capable of being approved;

20 This decision superseded an earlier (28 April 2014) decision in similar terms made by the Expenditure Review Committee of Cabinet.

- the documentation evidenced that approval had been given; and
- the only doubt was whether the approval had been given by the then Prime Minister through his undated²¹ correspondence or by Cabinet on 12 May 2014, with the department's legal advice concluding that the 'better view' was that the approval had been given by the then Prime Minister.

Was a robust process employed when approving the advance payments under the land transport legislation?

The May 2014 decision to make a \$500 million payment for stage one led to DIRD's analysis of the project proposal submitted by Victoria not being completed. As a result, funding approvals were given under both the land transport legislation and financial management framework but without there being any documented analysis and advice to Ministers that the statutory criteria for giving such approvals had been met.

2.15 Between 2009 and mid-September 2014, the delivery of land transport infrastructure investment programmes was governed by the *Nation Building Program (National Land Transport) Act 2009*. This legislation applied to the Infrastructure Investment Programme for the first 12 months following the change of government that occurred at the 2013 election.²² It provided a framework for the approval of projects, the provision of Commonwealth funding, and the determination of conditions attaching to that funding.

2.16 DIRD has published Notes on Administration that describe the framework for the approval of funding for projects included on the Infrastructure Investment Programme. These notes also set out the administrative processes that funding recipients must follow to claim payments, seek variations to project approvals and comply with the terms and conditions of approved funding. The notes emphasise that, while the Commonwealth may commit to funding a project at any time, the announcement of project funding (and its inclusion in the Infrastructure Investment Programme):

reflects the Australian Government's commitment to the objectives of the project but this does not obviate the need for Ministerial approval of a specific project proposal to achieve those objectives.

2.17 To give effect to the legislative provisions requiring that the relevant Minister only approve a project where satisfied the project is eligible for approval and appropriate for approval, DIRD had:

- adopted the *Best Practice Cost Estimation for Publicly Funded Road and Rail Construction* developed for it by consultants in June 2008. The Notes on Administration outlined that this standard must be applied when preparing cost estimates for projects for which Commonwealth funding is sought under the scope of these notes;

21 The legal advice noted that the undated letter from the then Prime Minister must have been dated prior to 12 May 2014.

22 From 11 September 2014, the legislation governing the Infrastructure Investment Programme has been the *National Land Transport Act 2014*.

- implemented a Project Proposal Report (PPR) template to facilitate the gathering of sufficient information on the planned approach and project scope to inform the Minister's decision on the approval of funding; and
- developed procedures for the analysis of information provided in PPRs so as to guide departmental recommendations to the Minister on the merits and risks of a project, with the results of this analysis to be reflected in an assessment report to be provided to the Minister before any project approval instrument is signed. The assessment template required the department to provide written advice to the Minister as to:
 - how a project met the eligibility and 'appropriateness' requirements of the land transport legislation;
 - the merits and benefits including the BCR for the project, as well as any identified disbenefits;
 - any potential risks relating to matters such as timeframes and slippage, project cost increases, environmental, heritage, or potential scope changes and the mitigation strategies; and
 - the procurement/delivery strategy for the project, as well as any issues/risks/mitigation strategies arising from that strategy.

Development of a PPR for stage one

2.18 Departmental records outline that, between February and April 2014, DIRD and Victorian state government officials worked on the development of a PPR for stage one of the East West Link project. There were various drafts of a PPR for stage one of the project provided to and commented on by DIRD, with the final version of the PPR submitted by Victoria on 22 April 2014.

2.19 The timing of the decisions made in the 2014 Budget context concerning funding and advance payments for the East West Link project meant that only some very limited departmental analysis of the PPR was undertaken.

Signing of the project approval instruments for each stage

2.20 Following the decisions taken in the budget context to commit a total of \$3 billion to the East West Link project, and to make advance payments of \$1.5 billion in 2013–14, on 16 June 2014, DIRD briefed the then Assistant Minister for Infrastructure and Regional Development recommending that he sign four project approval instruments. Two of those project approval instruments related to funding for the East West Link project.²³ The Minister was advised that it was necessary for him to sign those instruments in order for \$1.5 billion in payments to be made in relation to the East West Link project (\$500 million for the first stage, and \$1 billion for the second stage).

2.21 The instruments prepared by the department were signed by the Minister that same day. The instruments included a project number and name, and brief description of the project scope, the maximum amount of Commonwealth funding and the funding recipient. They also recorded

23 The other two instruments related to the WestConnex project in New South Wales and the Gateway Motorway North project in Queensland.

that the Minister was satisfied that each project was eligible and appropriate for approval under the relevant sections of the land transport legislation.

2.22 The briefing prepared by DIRD and provided to the Minister involved a significant departure from the process outlined in the published Notes on Administration. In particular, the department had:

- received, on 1 November 2013, the June 2013 full business case for stage one of the East West Link project from the Victorian Government but, although some work was undertaken with a view to engaging a contractor to assist with analysis of that document, analysis of the business case was not completed;²⁴
- received a PPR from Victorian officials (see paragraph 2.19) in respect to stage one, but only some very limited analysis of the finalised PPR was undertaken as such analysis was no longer needed to inform any decision-making in relation to the project. No PPR was received in relation to stage two as it had not been fully considered by the Victorian Government; and
- excluded from its briefing any assessment as to whether the approval of funding for either stage one or stage two of the East West Link project met the requirements of the land transport legislation.²⁵ Departmental records state that the departure from the documented assessment and briefing practices occurred because:

The Cabinet decision [*to make a prepayment on the East West Link and some other projects*] overrode the requirement to provide a decision brief as usual because the Government had already decided to approve the project and make a pre-payment.

24 In October 2015, DIRD advised the ANAO that some initial commentary was undertaken on the costing aspects of the business case. This was evidenced by internal departmental emails dated 10 December 2013, which raised a number of concerns.

25 For example, under Section 10(a) of the Nation Building Program (National Land Transport) Act 2009, to be eligible for approval a project must be included on the National Land Transport Network. In this respect, Victoria requested that the East West Link be added to the Network on 12 February 2014. However, the East West Link was not added until a 'Variation of National Land Transport Network Determination' was signed by the Minister on 22 December 2014.

Were the advance payments made before 30 June 2014 as intended?

Departments took the necessary action to make the payments on 30 June 2014.

2.24 The land transport legislation contains no appropriation to support the payment of funding for approved projects. Rather, payments for Infrastructure Investment Programme projects are made under the mechanism set up by the *Federal Financial Relations Act 2009* framework. This allows the Treasurer, through a written determination, to credit amounts to the COAG Reform Fund for the purpose of providing financial assistance to the states and territories.

2.25 On 26 June 2014, the Department of the Treasury advised the then Treasurer that he needed to sign a determination in order for an 'extraordinary national partnership payment of \$3610.3 million' to be made to the States and Territories on 30 June 2014. This amount included \$500 million for stage one of the East West Link project (as well as \$1 billion for stage two). The determination was signed on 27 June 2014, with the payment made on 30 June 2014.

2.26 Under the Intergovernmental Agreement on Federal Financial Relations, National Partnership Payments (such as those for the East West Link) require a written agreement to be in place to facilitate Commonwealth payments to States and Territories. The \$1.5 billion in advance payments for the East West Link project were made under the coverage of the National Partnership Agreement on Implementation of Major Infrastructure Projects in Victoria 2009–14. That agreement expired on 30 June 2014. It was replaced in October 2014²⁶ with the signing of the National Partnership Agreement on Land Transport Infrastructure Projects. The new agreement is to operate from 1 July 2014 to 30 June 2019.

26 The delay in the new Agreement being signed reflected some disagreement about changes being proposed by the Commonwealth, which included the insertion or enhancement of clauses relating to: payments made on achievement of agreed project milestones; use of probabilistic cost estimation; and the treatment of interest earned on payments in advance of the project.

3. Approval of Commonwealth funding for stage two of the project

Areas examined

Stage two of the East West Link related to the western section from the Port of Melbourne to the Western Ring Road. The ANAO examined how the Victorian Government request for funding towards this stage was progressed, including any analysis and advice prepared to inform decisions taken by Ministers in respect to this project.

Conclusion and findings

Funding for stage two was not an election commitment of the incoming Government. Rather, in early 2014, the Victorian Government requested \$3 billion in Commonwealth funding to expedite construction work. Funding of \$1.5 billion for stage two was included in the May 2014 Budget.

Prior to the finalisation of the 2014 Budget, relevant Commonwealth Government entities were not in a position to provide advice to Ministers on the merits of committing funding to stage two of the East West Link primarily because:

- the Victorian Government had not included stage two in its 2013 submission to Infrastructure Australia; and
- a business case had not yet been developed and the summary information provided by the Victorian Government in early 2014 was insufficient to enable an informed assessment of the merits, estimated costs and timeframe of stage two.

A decision was also taken in the 2014 Budget context to pay \$1 billion to the Victorian Government for stage two in 2013–14. The stage two payment was double the advance payment for stage one, notwithstanding that the stage two proposal was less well developed than that for stage one and there was no evidence to indicate that any payment of funds in 2013–14 would assist to accelerate work on stage two. In any event, the Commonwealth funding for stage two was contingent on works being underway by the end of 2015, not by 30 June 2014. There was also no evidence that the 2013–14 cash flow needs of stage two were greater than those of stage one.

Had the western section been included in the more recent Victorian submissions to Infrastructure Australia?

The approach taken by Victoria to seeking a Commonwealth funding contribution to stage two bypassed the Infrastructure Australia proposal submissions process.

3.1 The Minister for Infrastructure and Regional Development's 20 April 2014 correspondence to the then Prime Minister proposing \$1.5 billion in Commonwealth funding to commence stage two of the East West Link (see paragraph 2.12) outlined that earlier planning work for this project had been considered by Infrastructure Australia. That correspondence also outlined that the proposed Commonwealth funding was 'contingent on Victoria submitting an updated business case for the project to Infrastructure Australia' and the Minister's consideration of Infrastructure Australia's analysis.

3.2 Victoria's first submission to Infrastructure Australia, made in 2008, had included construction of a new east-west road tunnel as an alternative to West Gate Bridge at an estimated cost of \$3.5 billion. That proposal was not included on the first Infrastructure Priority List (published in May 2009) due to its low BCR and Infrastructure Australia having insufficient confidence in its deliverability.

3.3 Victoria's 2009 submission to Infrastructure Australia included a broader proposal, referred to as WestLink. This \$5 billion proposal involved a new 2–2.5km east-west road tunnel (stage one) and a road connection between Footscray and the Western Ring Road (stage two). This proposal was included on the June 2010 update to the Infrastructure Priority List in the 'real potential' category. Infrastructure Australia considered the project would probably need to be re-scoped to focus clearly on freight and public transport (rather than improving access to Melbourne's central business district) and had concerns about the preliminary nature of the project design and economic analysis.

3.4 The WestLink proposal was retained in the 'real potential' category on the June 2011 Infrastructure Priority List. In addition, Infrastructure Australia recommended that it receive project development funding from the Commonwealth on the basis that the current proposal did not provide an efficient or effective means of improving freight access to/from the Port of Melbourne. Project development funding from the Commonwealth was not forthcoming.

3.5 The Victorian Government's November 2011 submission included the East West Link, which was significantly broader in scope to the earlier WestLink proposal. It included both eastern and western components (now referred to as stages one and two), with a request for \$30 million in project development funding. The Priority Lists published in June 2012 and June 2013 included the proposal in the 'real potential' category with a recommendation that project development funding be made available.

3.6 A largely unchanged submission in relation to the East West Link proposal was submitted by Victoria in August 2012. The East West Link was retained in the 'real potential' category on the June 2013 Infrastructure Priority List until additional information was available (in particular, a business case). Infrastructure Australia also continued to recommend that the project development funding be provided.

3.7 It was not until late April 2014 that Infrastructure Australia received further information from the Victorian Government in respect to what had become known as stage two of the East West Link project.²⁷ This was nearly three years after the earlier WestLink proposal (which included works now part of stage two of the East West Link) had been included on the June 2011 Infrastructure Priority List.

²⁷ This comprised a project summary report and a draft interim business base.

When did the Victorian Government request construction funding for stage two of the East West Link project?

In early 2014, the Victorian Government requested \$3 billion of Commonwealth funding towards the construction of stage two.

3.8 Records held by the Department of the Prime Minister and Cabinet indicate that, in early 2014, the Victorian Government requested \$3 billion in Commonwealth funding to expedite construction work on stage two of the East West Link project. In respect to that request, February 2014 advice to the then Prime Minister from his department was that, given the limited information that was available at that time, it was not possible to make an informed assessment of the merits, costs and timeframes of stage two.

3.9 In the second half of March 2014, the then Victorian Premier wrote to the then Prime Minister providing a copy of a *Project Summary Report* for stage two. The stated purpose of providing this document was to inform negotiations in relation to the request for Commonwealth funding for stage two. In late April 2014, DIRD received a copy of that report as well as a slide presentation in relation to the project and a copy of a *Draft Interim Business Case* (dated 31 March 2014).

How well advanced was planning for stage two of the East West Link project at the time of the decision to make the \$1 billion payment?

At the time a Commonwealth funding commitment had been requested, and was approved, significant project development work needed to be undertaken in order for a business case to be prepared.

3.10 The draft interim business case outlined that significant project development work remained to be undertaken in order for a full business case to be prepared. For example:

- a lack of transport modelling had precluded detailed economic analysis being included (a BCR was not available); and
- the cost estimates were only preliminary, reflecting the stage of project development work undertaken to date. Key costing risks identified in the draft interim business case included geotechnical conditions, land acquisition and business continuity compensation requirements, scope and connectivity to the Western Ring Road.

3.11 Nevertheless, the draft interim business case provided some useful insights as to the likely timeframe over which stage two was expected to be delivered, and the associated funding requirements. In this respect, the project was identified as having four logical sub-sections, which provided flexibility in procurement and sequencing. In respect to sequencing:

- it was possible that favourable pricing to deliver the first sub-section (known as the Port Connection) could be obtained from the bidders for stage one, meaning construction of this sub-section could commence in 2015 while the full business case and other approvals were progressed; and
- procurement of the balance of the project could commence in 2016 with the full project completed by 2023.

How far in advance of project needs was the \$1 billion payment made?

Total expenditure on stage two was not expected to reach \$1 billion until 2016–17, long after the \$1 billion advance payment was made in June 2014.

3.12 As outlined at paragraph 2.12, in the context of finalising the May 2014 Budget, Ministers agreed to provide \$1.5 billion in funding for stage two of the East West Link. This commitment was announced on 29 April 2014, in a press release issued jointly with the then Victorian Premier.

3.13 Of the \$1.5 billion commitment to stage two, Ministers decided that \$1 billion was to be paid in 2013–14 as part of an Infrastructure Growth Package. The remaining \$500 million was budgeted to be paid in 2018–19 from within the Infrastructure Investment Programme.

3.14 The decision to provide funding to stage two, and make a payment in 2013–14, was taken in advance of any analysis being undertaken by either DIRD or Infrastructure Australia. Both entities had only recently received from Victoria some limited material on stage two. On 20 April 2014, the Minister for Infrastructure and Regional Development informed the then Victorian Premier that the \$1.5 billion funding contribution ‘to commence’ stage two was:

contingent on Victoria submitting an updated business case for the project to Infrastructure Australia and my consideration of Infrastructure Australia's analysis.²⁸

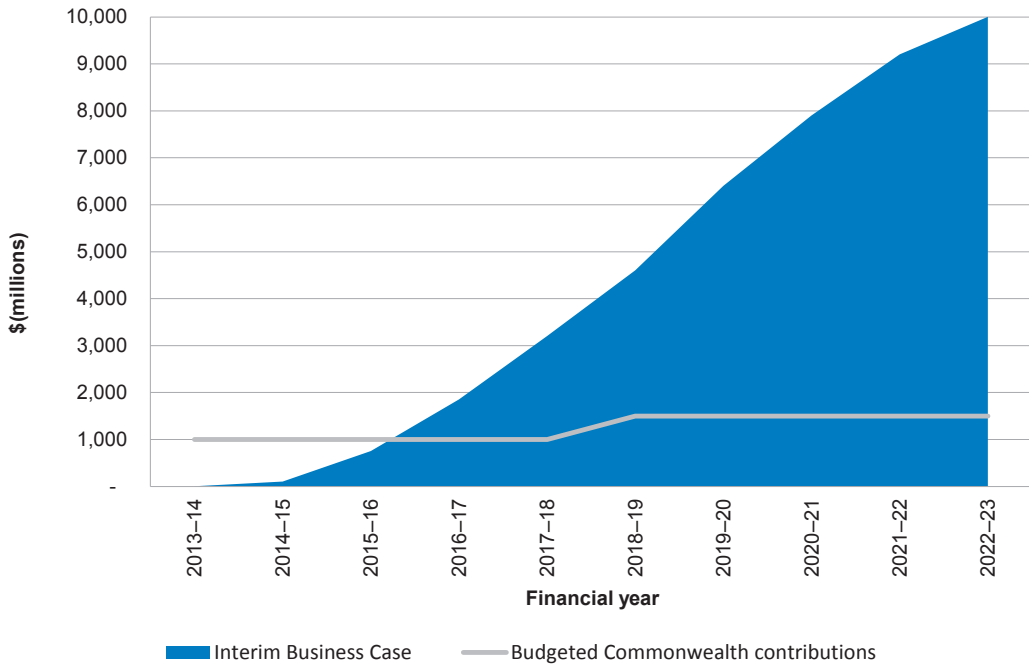
3.15 According to the information available at the time the stage two funding decision was taken by Ministers, the Victorian Government did not require \$1 billion in 2013–14 from the Commonwealth for stage two, nor did its requests for a funding commitment include any request for funds in 2013–14. Rather, stage two work in 2013–14²⁹ and 2014–15 was expected to be focused on preparing the full business case, site preparation, design work and planning approvals (with the latter expected to extend into 2015–16). While procurement activities and project delivery were envisaged to commence in 2015–16, total expenditure on stage two was not expected to reach \$1 billion until during 2016–17 (as illustrated by Figure 3.1).

3.16 The Commonwealth's payment to the Victorian Government of \$1 billion in 2013–14 for stage two of the East West Link project resulted in the estimated fiscal balance deficit for 2013–14 being \$1 billion higher than would otherwise have been the case had payments been linked to the expected cash flow needs of the project. As a corollary, the estimated fiscal balance deficits for 2014–15 and 2015–16 included in the May 2014 budget papers were lower as a result of the advance payment.

28 However, this condition was not reflected in the project governance arrangements – see paragraphs 4.5 and 4.12.

29 The only expenditure identified by Victoria for 2013–14 involved \$4 million to commence preparation of the full business case.

Figure 3.1: Projected stage two project cash flows



Source: ANAO analysis of departmental records.

Was appropriate work undertaken to prepare for the possible provision of a concessional loan in addition to grant funding?

DIRD obtained advice on the possible provision of a concessional loan (in addition to grant funding) towards the costs of stage two. That advice was paid for through funding that had been intended for applied analysis and applied research to improve transport operations, rather than departmental administrative costs. The advice from DIRD that led to legislation amendments that allowed this to occur did not draw to the Minister’s attention the change from the original policy rationale.

3.17 As outlined at paragraph 2.12, in the context of finalising the May 2014 Budget, Ministers agreed to provide \$1.5 billion in funding for stage two of the East West Link. This commitment was announced on 29 April 2014, in a press release issued jointly with the then Victorian Premier.

3.18 The Minister for Infrastructure and Regional Development’s 20 April 2014 correspondence to the then Prime Minister proposing \$1.5 billion in Commonwealth funding to commence stage two of the East West Link (see paragraph 2.12) stated that:

should Victoria require additional assistance from the Australian Government to complete this project through a concessional loan, then I have advised the Victorian Premier that he should provide details of such a proposal as soon as possible.

3.19 The possible provision of a concessional loan of up to \$3 billion was examined by DIRD between March and June 2014 (in consultation with the Victorian Department of Treasury and Finance), including through the engagement of a consulting firm. As it eventuated, a concessional

loan arrangement was not entered into. The cost of the consulting work was funded under Part 4 of the *Nation Building Program (National Land Transport) Act 2009* (land transport legislation).

3.20 Consistent with the original intent of land transport legislation, funding approved under Parts 4 and 5 of the land transport legislation was introduced to fund applied analysis and applied research to improve the efficiency and safety of transport operations through, for example, the development of transport data sets; planning investigations and feasibility studies; and the developing and trialling of new technologies and practices.

3.21 In recent years, funding under Parts 4 and 5 has been increasingly used to cover costs that would traditionally have been met under DIRD's departmental appropriation.³⁰ Further, departmental records have shown instances where single engagements for advisory services have been partially funded under Part 4 with the remainder from DIRD's departmental appropriations.

3.22 This use of Part 4 and 5 was made possible by changes to the legislation to include non-corporate Commonwealth bodies and partnerships in the definition of eligible funding recipient. The legislation changes had been informed by legal advice obtained by the department that this change would allow the Australian Bureau of Statistics to receive funding. The advice provided to Ministers on this change to the legislation did not address that such use of this funding by DIRD would represent a changed approach from the policy rationale that underpinned the inclusion of Parts 4 and 5 in the land transport legislation.

3.23 More recently, DIRD's administration of Parts 4 and 5 has involved the development of guidelines and an internal application process to allow for a process of internal 'bids' for funding under Parts 4 and 5. All bids received in the 2013–14 year were endorsed by DIRD and recommended to the Minister for a total of \$48.5 million funding in mid-March 2014. Of this, \$10.85 million (or 22 per cent) was approved for activities that were able to have been met through departmental appropriations. For example, \$3.75 million was approved for the continuation of the 'Assurance and Compliance Programme' (encompassing the Roads to Recovery reviews)³¹, as well as \$2.5 million for a 'Financing Due Diligence' project. In November 2015, DIRD advised the ANAO that its perspective was that all use of Parts 4 and 5 funding has been consistent with both the intent and scope of the legislation.

3.24 According to the funding 'bid', the financing due diligence allocation was to 'allow for high level due diligence to be undertaken in relation to potential funding and financing solutions for appropriate projects in the Infrastructure Investment Programme.' It was under this allocation that DIRD engaged a firm for the provision of 'expert advice on commercial terms for a concessional loan' of up to \$3 billion from the Commonwealth for the second stage of the East West Link.

3.25 In October 2015, DIRD commented to the ANAO that it did not consider there was anything inappropriate with its use of Part 4 and 5 funding.

30 For example, as part of DIRD's management of the Roads to Recovery Programme, it engages consultants to 'assess state, territory and local governments ... in their delivery of selected [Roads to Recovery] projects'. Previously paid for from departmental appropriations, the costs of this compliance activity have been met through Part 5 since July 2013.

31 Included in the 'request for funding' template was the question: 'Are there possible alternative sources of funding? To which the application for the Assurance and Compliance Programme responded: 'No – it is not practical to utilise Departmental funding for the A&CP assessments as it would significantly limit the number of assessments that could be undertaken.'

4. Governance arrangements to administer the approved funding

Areas examined

The ANAO examined the governance arrangements put in place for the administration of the Commonwealth's financial commitments to the East West Link. The ANAO also examined how much of the advance payments have been used, and whether the Commonwealth is able to require the return of unused funds from the Victorian Government.

Conclusion and findings

A number of governance documents applied to the \$1.5 billion in advance payments made for the East West Link project. Two of these, being the relevant National Partnership Agreement and a Memorandum of Understanding, are not, by their nature, legally binding and enforceable documents. One consequence was that neither document provided any legal basis to require the Victorian Government to return the advance payments when the incoming state government cancelled the project.

The two approval instruments that had been signed in June 2014 under the *Nation Building Program (National Land Transport) Act 2009* (the land transport legislation) to allow the advance payments are legally binding. But those instruments lacked important details of the scope of works the Commonwealth was, and was not, funding. DIRD's attendance at the Victorian Government's project steering committee meetings enabled it to take prompt action to have the project approval instrument for stage one varied to manage the heightened risks to the Commonwealth that construction work may be delayed or not proceed.

Due to a continuing lack of detail being available, the stage two instrument (signed in June 2014) was not able to be varied. Another shortcoming was that two Ministerial conditions on the approval of stage two funding were not reflected in any of the project-specific governance documentation.

Victoria has reported that none of the \$1.5 billion in advance payments was used prior to the project being cancelled. Recovery of the advance payments had not, as of October 2015, occurred. Interest on the advance payments to the end of October 2015 is estimated to be more than \$49 million.

Area for improvement

The ANAO has made one recommendation to the Department of the Treasury for it to commence action under the federal financial relations framework to recover the advance payments from Victoria.

Did attendance at steering committee meetings provide the Commonwealth with appropriate oversight of project progress?

Attending meetings of the East West Link project steering committee allowed DIRD to have greater oversight of, and obtain valuable insights concerning, Victoria's development of the stage one project.

4.1 In November 2013, DIRD wrote to the Victorian Department of Transport, Planning and Local Infrastructure requesting that it be formally represented on Victoria's East West Link project

steering committee. The attendance of a departmental official at the meetings commenced in December 2013.³² Departmental records indicate that it was represented (either in person or via teleconference) at 80 per cent of the steering committee meetings that were held over that period. In October 2015, DIRD advised the ANAO that the Victorian Government made it a condition of participation that the Commonwealth attendance at these meetings be a representative at Deputy Secretary level. The relevant Deputy Secretary was unable to attend some of the meetings.

4.2 Attendance at the meetings allowed DIRD to gain greater oversight of, and obtain insights concerning, Victoria's development of the stage one project. For example, attendance at a series of urgent steering committee meetings between 18 and 29 September 2014³³ provided DIRD with a greater awareness of Victoria's handling of unresolved legal challenges concerning the project, the development of contract terms and conditions—specifically the negotiation of the 'termination for convenience' clause—and an accompanying side-letter, as requested by the successful tenderer (East West Connect). It was against this background that DIRD recommended the stage one project approval instrument be varied (see paragraphs 4.6 to 4.8).

Were the project approval instruments effectively drafted?

Due to the lack of detailed information that was available when the funding commitments were made, the project approval instruments signed in June 2014 to allow the advance payments to be made inadequately set out the scope of both stage one and stage two of the East West Link project. The stage two instrument was remiss in not including relevant conditions on the award of that funding. DIRD took timely action to improve the stage one instrument once more detailed information was available, and in light of concerns the project may be cancelled.

4.3 A project approval instrument is the formal document signed by a Minister under the land transport legislation to approve funding for a project. The legislation requires that each instrument identify the project, specify the maximum funding amount that the Commonwealth may contribute to the project and identify the eligible funding recipient to which the funding may be paid. It also provides that project approval instruments may exclude one or more specified purposes from being purposes on which funding may be expended.

4.4 There were two project approval instruments signed on 16 June 2014 by the then Assistant Minister for Infrastructure and Regional Development in relation to the East West Link project. One related to the \$500 million advance payment for stage one with the second related to the \$1 billion advance payment for stage two. Each instrument included a brief description of the project scope, the maximum amount of Commonwealth funding and the funding recipient. Neither specified any purposes for which funding was not to be expended. In October 2015, DIRD advised the ANAO that the legislation outlines the conditions of funding and project approval instruments do not usually set out specified purposes for which funding is not to be expended.

32 The steering committee was disbanded following the change of Victorian Government in November 2014.

33 There were six meetings held within this period, at which DIRD was represented during the first five via teleconference.

4.5 The brevity of the project scope included in each instrument reflected that considerable work was still required by the Victorian Government before construction work on either stage would be ready to proceed. In the context of the considerable advance payments that were made, this lack of detail, and the absence of any prescription in the approval instruments of the purposes for which funding could not be used, exposed the Commonwealth to heightened risk. In addition, the stage two approval instrument excluded any reference to two conditions for the approval of the advance payment for the western section that had been decided upon by Ministers (and had been reflected in Ministerial correspondence). Specifically, the stage two funding was to be contingent on:

- work on the project being underway by the end of 2015 (see paragraph 2.12); and
- Victoria submitting an updated business case for the project to Infrastructure Australia and the Minister for Infrastructure and Regional Development's consideration of Infrastructure Australia's analysis (see paragraph 3.14).

4.6 This situation was reflected in advice provided by DIRD to its Ministers across September and October 2014. The department drew attention to unresolved legal challenges to the project proceeding, as well as the Victorian opposition affirming in the lead up to the November 2014 Victorian state election that, if elected to government and if legally binding construction contracts were not in place, it would not proceed with the East West Link project.

4.7 In line with DIRD's advice, on 27 October 2014 the stage one approval instrument was varied by the Minister for Infrastructure and Regional Development to:

- provide greater detail about the works, reflecting the project scope agreed during negotiations between the Victorian Government and the consortium that had been selected to design, construct and operate the eastern section of the East West Link; and
- exclude Commonwealth funding being used as payment for any penalties, legal costs or court ordered costs that may be incurred should stage one be delayed or cancelled.

4.8 The difference between the original instrument, signed in June 2014, and the revised instrument, signed in October 2014, is illustrated in Figure 4.1.

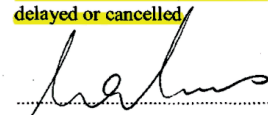
4.9 Similarly, by June 2015 DIRD had advised the Minister that it was necessary to vary the original approval instruments for two of the three other projects that received advance payments on 30 June 2014.³⁴ Of the four project approval instruments that had been signed to allow advance payments for land transport infrastructure projects to be made on 30 June 2014, only the instrument for stage two of the East West Link remains in its original form. This reflects that more precise information on the scope for that stage was not available, and the procurement processes for the work had not proceeded to a stage where there was any risk of contract payments being required in the event the project was delayed or cancelled.³⁵

34 These projects were the WestConnex project in New South Wales and the Gateway Upgrade North project in Queensland.

35 Further illustrating this situation, the Victorian schedule of projects to the National Partnership Agreement on Land Transport Infrastructure Projects signed in October 2014 did not include figures for stage two in relation to the total project cost, the total state contribution or the total of any other contributions.

Figure 4.1: East West Link eastern section project variation

Variation is to reflect the more detailed specification to the project scope agreed between the Victorian Government and East West Connect on 29 September 2014 and add excluded purposes to specifically exclude Commonwealth funding from being used as payment for any penalties, legal costs or court ordered costs that may be incurred should the Eastern Section of the project be delayed or cancelled.



WARREN TRUSS

27.10.14

Project Details

Project Number	051190-13VIC-NP
Project Name	East West Link - Eastern Section
Road Name	NATIONAL NETWORK
Project Scope	<p>This project involves the planning, development, procurement and construction of the Eastern section (Stage 1) of the East West Link from Eastern Freeway in Clifton Hill to CityLink in Parkville including:</p> <ul style="list-style-type: none"> • construction of a new 6.6 kilometre freeway link from the Eastern Freeway to CityLink; • two 4.4 kilometre, three lane tunnels with entrance and exit ramps at the Eastern Freeway at Hoddle Street, Ormond Road and Mount Alexander Road; • a vehicle overpass at Hoddle Street; • a pedestrian bridge over the Eastern Freeway; • a pedestrian and cycle bridge at Flemington Station; • a new road link between Mount Alexander Road and Racecourse Road; and • the widening of sections of CityLink, the Eastern Freeway, Hoddle Street and Mount Alexander Road.
Maximum Funding Amount that the Commonwealth may Contribute	\$500,000,000
Eligible Funding Recipient	Department of Transport (VIC)
Excluded Purposes	Payment of costs resulting from the delay or cancellation of the project, including but not limited to contractually based penalties, legal costs or court ordered costs.

Note: Variations to original project approval instrument are highlighted in yellow. Text not highlighted in yellow was included in both the June 2014 and October 2014 instruments.

Source: Departmental records.

Was the Memorandum of Understanding effective in helping to manage risk?

The Memorandum of Understanding was not an effective approach to managing the particular risks involved with approving funding, and making advance payments, prior to the project having proceeded fully through the processes that have been established to assess the merits of nationally significant infrastructure investments.

4.10 As has occurred with some other land transport infrastructure projects and is common when managing federal relations, a Memorandum of Understanding (MoU) was developed to apply to the East West Link project. DIRD worked with the Victorian Department of Treasury and Finance between early March 2014 and late June 2014 to develop the MoU for the East West Link project. The MoU was signed on 28 June 2014 by the then Prime Minister and the then Victorian Premier.

4.11 The MoU covered arrangements for Commonwealth contributions to both stages of the East West Link project. Its stated purpose was to set out the intention of the parties with respect to the arrangements for a Commonwealth contribution to fund the project and business arrangements between the Commonwealth and Victorian governments. Advice prepared by DIRD for its Ministers in June 2014 drew attention to two key components of the MoU:

- if the project is cancelled, any payments made on the project were to be repaid to the Commonwealth; and
- any interest earned on Commonwealth funding was to be separately identified and used on the project, unless its use on another project was agreed between the Commonwealth and the Victorian Government.

4.12 In a number of important respects (see Table 4.1) , the MoU sought to strengthen the Commonwealth's position compared with the provisions of the National Partnership Agreement that applied at the time the advance payments were made. However, the MoU did not give effect to two conditions for the approval of the advance payment for stage two that had been decided upon by Ministers (see paragraph 4.5).

Table 4.1: Arrangements for project cancellation and treatment of interest earnings under the 2009–14 National Partnership Agreement and Memorandum of Understanding

	National Partnership Agreement	Memorandum of Understanding
Project savings	Savings to be applied to other projects in Victoria, as agreed between the parties.	Savings to be returned to the Commonwealth; OR savings can be applied to other projects in Victoria, as agreed between the parties.
Interest earned on Commonwealth funding	Interest earned to be used on the project.	Interest earned to be separately identified and used on the project; OR applied to other projects in Victoria, as agreed between the parties.
Project cancellation	Commonwealth funding reallocated to another project in Victoria; OR another State or Territory.	All funding to be returned to the Commonwealth. ^(a)

Note a: Which may be facilitated via adjustments to the total monthly National Partnership payments, resulting in negative payments under the relevant agreement.

Source: ANAO analysis of departmental records.

4.13 In addition, the MoU (as is the case with all MoUs—and the National Partnership Agreement) was not intended to be, and was not, a legally binding and enforceable document. As a result, neither document creates or imposes any legally binding obligations, duties or responsibilities on the parties. In this respect, legal advice to DIRD in September 2014 (as part of the process that led to the stage one project approval instrument being varied) indicated that the MoU did not protect the Commonwealth's financial interests but that the relevance of the document was more 'moral/political'.

4.14 The non-binding nature of the MoU (and National Partnership Agreement) meant that these documents provided the Commonwealth with no legal right to require the Victorian Government to return the \$1.5 billion in advance payments after the incoming state government notified the Commonwealth that the project was being cancelled (see Figure 1.2). Rather, legal advice obtained by the Department of the Treasury in September 2015 was that recovery could be required if the Treasurer made a determination under section 20 of the *Federal Financial Relations Act 2009*.³⁶ Specifically, that Act empowers the Treasurer (or another Treasury portfolio Minister) to make a determination requiring funds to be repaid if a state does not fulfil a funding condition. The relevant condition had been imposed by the land transport legislation through 'a positive requirement' on Victoria to spend the \$1.5 billion on the East West Link project.

4.15 As of October 2015, the Department of the Treasury had not recommended that the Treasurer sign a determination requiring repayment and recovery of the advance payments had not occurred.

36 As outlined at paragraph 1.3, on 27 June 2014 the then Treasurer signed a determination under that Act to enable the \$1.5 billion to be paid.

Recommendation No.1

4.16 The ANAO recommends that, as a matter of priority given the significant amount of Commonwealth funding that is involved, the Department of the Treasury recommend to the Treasurer that he make a determination requiring the return of the \$1.5 billion paid to Victoria in relation to the East West Link project.

Entity response: *Agreed with qualifications.*

4.17 *The Treasury has provided advice to the Treasurer on options for recovery of the \$1.5 billion paid to Victoria in relation to the East West Link project, including in relation to his powers under section 20 of the Federal Financial Relations Act 2009.*

4.18 *The Commonwealth Government and Victorian Government continue to discuss options to resolve this matter.*

How much of the Commonwealth funding has been spent?

None of the Commonwealth funding was used on the East West Link project. Instead, these funds have been earning interest for Victoria.

4.19 The standard monthly reporting arrangements DIRD has in place for land transport infrastructure projects have applied to the East West Link advance payments.³⁷ In this respect, as at July 2015, Victoria had reported that there had been no expenditure against either the \$500 million stage one advance payment or the \$1 billion stage two advance payment.

4.20 Based on the methodology used by the Department of the Treasury in March 2015 to advise the then Treasurer's office, the ANAO estimated that interest earned on the advance payments to the end of October 2015 would have been more than \$49 million.



Grant Hehir
Auditor-General

Canberra ACT
14 December 2015

³⁷ As part of States and Territories' reporting arrangements outlined in the National Partnership Agreement and Notes on Administration, funding recipients enter project expenditure data on a monthly basis directly into DIRD's Infrastructure Management System for each of their projects.

Appendices

Appendix 1 Entities' responses

The formal responses received by ANAO from Infrastructure Australia and the Departments of Infrastructure and Regional Development and Finance following circulation of the draft report have been reproduced on the following pages.



Australian Government
Infrastructure Australia

Infrastructure Australia
Level 21, 126 Phillip Street, Sydney NSW 2000
GPO Box 5417, Sydney NSW 2001
Telephone (02) 8114 1900 Facsimile (02) 8114 1932
www.infrastructureaustralia.gov.au

17 November 2015

Mr Brian Boyd
Executive Director
Performance Audit Services Group
ANAO
19 National Circuit,
Barton ACT 2600

Dear Mr Boyd,

Thankyou for your letter dated 23 October 2015, providing an opportunity for Infrastructure Australia to comment on the proposed ANAO report into the Approval and Administration of Commonwealth Funding for the East West Link Project.

Infrastructure Australia notes the report and believes that it accurately reflects Infrastructure Australia's role in the analysis of the East West Link Project.

I look forward to seeing the final report once it is complete.

Yours sincerely

Philip Davies
Chief Executive Officer



GED
24 NOV 2015
G.20



Australian Government
Department of Infrastructure and Regional Development

Secretary

File Reference:
Contact:

Ms Michelle Kelly
Group Executive Director
Performance Audit Services Group
Australian National Audit Office

Dear Ms Kelly

ANAO Audit of the Approval and Administration of Commonwealth Funding for the East West Link Project

I refer to the letter from Mr Mark Simpson, A/g Group Executive Director, of 23 October 2015 seeking a response to the proposed audit report on the Approval and Administration of Commonwealth Funding for the East West Link audit pursuant to sub section 19(1) of the *Auditor-General Act 1997*.

The Department's summary and full responses on the proposed report are provided at Attachment A.

Please contact Mr Alex Foulds, General Manager, South East Roads Branch, Infrastructure Investment Division on 6274 8222 if you would like to discuss this response.

Yours sincerely

Mike Mrdak

6 November 2015

Summary of Department's response

The Department of Infrastructure and Regional Development (the Department) notes the ANAO's positive findings in relation to the Department's timely, thorough and appropriate advice on, and administration of, Commonwealth funding for the proposed East West Link Project.

Department's response

The Department of Infrastructure and Regional Development (the Department) notes the ANAO's positive findings in relation to the Department's timely, thorough and appropriate advice on, and administration of, Commonwealth funding for the proposed East West Link Project.

While generally in agreement with the ANAO's comments relating to the Department's advice and administration, the Department takes this opportunity to highlight issues that require additional comment or clarification.

The ANAO states that the project approval instruments did not sufficiently set out the scope of both stages of the proposed project due to the lack of detailed information that was available when the funding commitment was made. In addition, the ANAO considers that the two conditions relating to Stage 2 funding should have been included in the approval instrument.

The Department notes that these conditions were clearly specified in correspondence between the Australian Government and Victorian Government. Additionally, the inclusion of conditions in the project approval instruments is not a standard practice as the *National Land Transport Act 2014*, which at the time of the approval was the *Nation Building Program (National Land Transport) Act 2009*, addresses a number of standard conditions for which Australian Government funding can and cannot be used. This is further specified in the Notes on Administration.

The ANAO notes that the funding was provided in accordance with the National Partnership Agreement and Memorandum of Understanding both of which are not legally binding. The Department notes these are commonly used as a government preference to manage federal relations across all jurisdictions. As the ANAO indicates, the *Federal Financial Relations Act 2009* provides the legal means to recover the advance payments from Victoria.

In relation to the use of administered funding under Parts 4 and 5 of the then *Nation Building Program (National Land Transport) Act 2009*, the Department has supportive legal advice on its use of administered funding. In October 2015, the ANAO acknowledged that the Department had acted in accordance with the Act. The Department's actions remain consistent with both the intent and scope of the Act. It should be noted that because a particular expenditure could have been funded from departmental funding does not mean it therefore cannot be funded from administered funding. In addition, the Deputy Prime Minister was made aware of the broadening of the application of the use of Part 4 and 5 funding before the 2014 legislative amendments and, subsequently approved the specific, appropriate uses for which the administered funding was used.



Australian Government
Department of Finance

Jane Halton AO PSM
Secretary

Our Ref: SEC0012716

Mr Mark Simpson *19/11/15*
Acting Group Executive Director
Australian National Audit Office
GPO Box 707
CANBERRA ACT 2601

Dear Mr Simpson

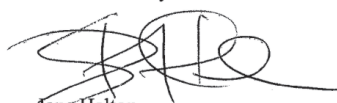
Thank you for your letter of 23 October 2015, providing the Department of Finance with an opportunity to comment on the proposed Australian National Audit Office audit report on the Approval and Administration of Commonwealth Funding for the East West Link Project.

The Department of Finance notes the audit report and supports the recommendation.

The following comments are for inclusion in the report summary.

The Department of Finance acknowledges the findings of this report and supports the recommendation.

Yours sincerely


Jane Halton
Secretary

13 November 2015

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