

Management of the Pre-construction Phase of the Inland Rail Programme

Australian Rail Track Corporation

Department of Infrastructure and Regional Development

Department of Finance

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Canberra ACT
27 September 2017

Dear Mr President
Dear Mr Speaker

The Australian National Audit Office has undertaken an independent performance audit in the Australian Rail Track Corporation, the Department of Infrastructure and Regional Development and the Department of Finance titled *Management of the Pre-construction Phase of the Inland Rail Programme*. 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

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Summary and recommendations

Background

1. The Inland Rail programme is to construct an inland rail line from Melbourne to Brisbane, covering a total distance of approximately 1700 kilometres. In 2014, the Australian Government provided \$300 million for pre-construction work on the proposed rail line, and in 2017 committed \$8.4 billion to build it. The Australian Rail Track Corporation (a wholly government owned business enterprise) is undertaking the pre-construction work, and has been selected by government to deliver the full programme of works over the next seven years, 2017–18 to 2024–25.

2. The Australian Government's commitment to build the Inland Rail in its entirety, and confirmation that the Australian Rail Track Corporation was best placed to deliver it, were announced during the course of the pre-construction activities. The timing of these decisions created challenges for the Australian Rail Track Corporation in managing the pre-construction programme.

Audit objective and criteria

3. The audit objective was to assess whether value for money was being delivered by the Australian Rail Track Corporation's management of the pre-construction phase of the Inland Rail programme. To form a conclusion against the audit objective the Australian National Audit Office examined whether:

- governance arrangements were appropriate, and administration of grant funding was effective; and
- the Australian Rail Track Corporation's procurement activities provided value for money and were supported by Information and Communications Technology systems and appropriate policies and procedures.

Conclusion

4. In managing the pre-construction phase of the Inland Rail programme, the Australian Rail Track Corporation (ARTC) could have had a greater focus on achieving value for money in procurement activities. The ARTC identified the need to improve existing business functions and procurement practices throughout the pre-construction phase, and commenced initiatives to strengthen administration. These initiatives need to be fully implemented to support the ARTC in effectively managing the full Inland Rail programme in coming years and delivering value for money.

5. Governance arrangements for the pre-construction phase of the Inland Rail programme were appropriate, although there was not timely implementation of the Minister's decision that a funding agreement be developed between the Department of Infrastructure and Regional Development and the Australian Rail Track Corporation. The Australian Government's longer term intent with regard to the delivery and full construction of the Inland Rail was appropriately considered, including through the administration of grant funding. There could have been more emphasis on achieving value for money in procurement and contracting activities, including for

the ARTC's contracting of staff for the programme, and improved planning for the leasing of property.

6. Testing of a sample of 54 procurements for the Inland Rail programme found a lack of consideration given to competition in the early phase of the programme, where a considerable proportion of procurements (17 per cent of the sample) were sole sourced. Procurement activities improved during the sampling period, as new systems, processes and practices were implemented. The ARTC's established Information and Communications Technology (ICT) systems and procurement and document management processes and practices were well short of the needs of the Inland Rail programme. The ARTC is further reviewing its procurement policies and procedures and supporting business functions for the full construction of Inland Rail.

Supporting findings

Governance and funding arrangements

7. Governance arrangements oversighting the pre-construction phase of the Inland Rail programme were appropriate, in so far as they adapted to the different stages of the implementation of the programme, and considered the Australian Government's interests with regard to longer term decisions about the delivery of the complete Inland Rail. There was no evidence however, that due consideration had been given to matters raised about the skills and status of committee members, specifically in relation to departmental representation. There could also have been more emphasis on achieving value for money in procurement and contracting activities. The ARTC's internal governance arrangements were appropriate, with a high level of engagement by the company's Board throughout the pre-construction phase. The ARTC is strengthening its processes to manage risk, and needs to implement a suitable system to support the management of risk in the Inland Rail programme.

8. Grant funding was appropriately managed for each of the four funding packages provided for the pre-construction phase of the Inland Rail programme. There was extensive engagement between the ARTC and the Department of Infrastructure and Regional Development (Infrastructure) in preparing the funding submissions, and Infrastructure appropriately assessed the submissions and approved milestone delivery payments. Protecting the Commonwealth's interests centred on how best to use the funds, given the status of the project over the longer term and the ARTC's role in delivering it. However, high-level deliverables, outcomes and reporting arrangements were not developed through the Minister's required funding agreement for the pre-construction phase, which could have supported greater emphasis on obtaining value for money in procurement activities associated with the milestone deliverables identified in the grant funding submissions.

9. The ARTC has maintained separate costs for the pre-construction phase of the Inland Rail programme, from commencement of the programme in 2014. These costs were more effectively administered some two years into the programme, with the implementation in August 2016 of upgrades to the company's financial management system that allowed more detailed allocation and monitoring of costs. The ARTC has secured additional office accommodation for staff in the Inland Rail programme, but in the absence of a property plan for the programme or for the ARTC's property needs more broadly, it cannot be assured that it is achieving value for money in leasing costs. Similarly, staffing requirements for the programme have been met through contracting

arrangements for specialist staff, but with no forward plan as to the requirements of the programme. However, these arrangements have provided flexibility in recruitment, and will likely be a source of workforce skills in the longer term. The ARTC needs appropriate procurement processes in place to ensure transparency and value for money in securing contracted staff, as in all other contract arrangements.

Procurement

10. The ARTC did not have appropriate ICT systems to support procurement for the pre-construction phase of the Inland Rail programme. There was a heavy reliance on manual processes, paper-based approvals and non-standardised records management procedures. As at July 2017, specifically for the Inland Rail programme, the ARTC has upgraded the Contracts module and implemented a Tenders management module in the corporate Financials & Supply Chain system, and is at an early stage in deploying a system for records management. These improvements, if fully bedded down, with intended functionality being utilised and supported by updated procedural documentation, would strengthen the Inland Rail programme's procurement processes and records management, and could have application more broadly across the ARTC.

11. The ARTC did not have appropriate policies and procedures to support procurement for the pre-construction phase of the Inland Rail programme. Established procurement policies and procedures were not sufficiently robust for the administration of the Inland Rail programme. The Inland Rail team is subsequently developing a suite of procurement policies and procedures specifically for the programme, although many were still in draft form as at July 2017. If finalised and fully implemented, these documents should support a level of rigour in the programme's procurement practices not previously evidenced, and could also be applied more broadly across the company.

12. Testing of a sample of procurements undertaken between 29 April 2014 and October 2016 for the pre-construction phase of the Inland Rail programme found shortcomings in providing value for money. There could have been greater consideration of competition in the selection processes, although the use of non-competitive procurement methods was concentrated in those procurements undertaken prior to July 2015. In the sampled procurements conducted after that date, there were improvements in the levels of competitive procurements and documentation. Evidence of the importance of probity in procurement is shown through ARTC's contracting procedure, but testing identified insufficient documentation of the reasons for or against using a probity advisor. The testing also showed many variations to contract values that were not sufficiently explained, and work commencing prior to contract execution. These issues had been identified in ARTC internal audits. A review of the documentation for four later procurements showed improvement in the procurement process, consistent with the upgrade in the systems and newly developed policies and procedures supporting procurement for the Inland Rail programme.

Recommendations

Set out below are the ANAO's recommendations and the ARTC's response.

Recommendation no.1
Paragraph 2.32 To improve the management of risk, the Australian Rail Track Corporation accelerates the implementation of a fit-for-purpose risk management system for the Inland Rail programme.

Australian Rail Track Corporation response: *Agreed in principle.*

Recommendation no.2
Paragraph 3.14 To improve records management, the Australian Rail Track Corporation:

- (a) revisits the scope and timeline of the Electronic Content Management review to incorporate the Inland Rail programme; and
- (b) reviews and updates its records management policies and procedures.

Australian Rail Track Corporation response: *Agreed in principle and underway.*

Recommendation no.3
Paragraph 3.32 To support transparency and value for money in contracting arrangements for the construction of the Inland Rail, the Australian Rail Track Corporation:

- (a) develops and implements policies and procedures that have suitable regard to Commonwealth procurement and contract management standards, recognising that the company is not bound by the Commonwealth Procurement Rules;
- (b) implements full functionality and controls available in procurement and contract management systems modules; and
- (c) monitors performance in procurement and contract management through increased internal audit activity and / or the implementation of a quality assurance process.

Australian Rail Track Corporation response: *Agreed in principle with qualification.*

Key learnings and opportunities for improvement for Australian Government entities

Below is a summary of key learnings identified in this audit report that may be considered by other government business enterprises when developing and implementing pre-construction programs.

Governance arrangements

- To monitor the achievement of value for money, governance arrangements should include effective oversight of key areas of spending, such as procurement and contracting, property and staffing.
- Where there is a grant funding arrangement between a government business enterprise and shareholder Minister's department for a program, it should be finalised in a timely manner and include high-level deliverables, outcomes and reporting arrangements.
- There should be active internal audit and quality review of infrastructure programs to help ensure that administrative systems and processes are functioning as required, including ICT, records management and risk management.

Procurement

- To strengthen contracting activities, entities should assess the potential benefits of utilising the full functionality of their business systems (such as contracts and tender management modules).
- While government business enterprises are not subject to Commonwealth Procurement Rules, the enterprise's procurement policy should clearly articulate its procurement principles and approaches.
- To demonstrate value for money in procurement, entities should clearly document the reasons for adopting single source tenders, contract variations and instances where work commences prior to contract execution. Entities should also clearly document probity processes.

Summary of entity responses

13. A summary of entity responses are below, with full responses provided at Appendix 1.

Department of Infrastructure and Regional Development

The Department supports the recommendations provided in the report. As the report notes as part of its delivery of Inland Rail, the ARTC has already commenced action that will improve ARTC's procurement practices and risk management processes. I expect the ARTC Board will have due regard to the report and will take action for the timely completion of the report's recommendations. Further to this, I expect the ARTC Board will provide regular advice to the Shareholders Ministers confirming how and when all of the recommendations will be implemented.

Department of Finance

Finance agrees with the ANAO's recommendations. The Government announced in the 2017–18 Budget that it will invest a further \$8.4 billion in equity in the Australian Rail Track Corporation to

deliver the Inland Rail project. The ANAO's findings will assist agencies and the ARTC, and will inform appropriate oversight and governance arrangements related to the delivery of the project. To this end, a Secretary-level Sponsors Group, including the Chairperson of the ARTC, has been established to closely monitor progress of the project.

Australian Rail Track Corporation

ARTC takes audit recommendations very seriously and has an ongoing commitment to continuous improvement. ARTC acknowledges your findings and your recognition in the body of the report that process improvements have already been made. At the same time, ARTC acknowledges the positive feedback on governance and the appropriate management of grant funding.

As a general observation, ARTC considers the findings do not adequately reflect the uncertainty and lack of clarity associated with the initial funding, longevity and responsibilities for the Programme during the period when decisions were being made as to the future of the Inland Rail project. Indeed, it was only in May 2016 that ARTC was confirmed as the delivery agency and in the May 2017 Budget that the funding commitment was confirmed. This imposed constraints on ARTC's approach to procurement, contract management and the project's risk management approach.

Notwithstanding this high level of uncertainty, 45 out of 54 tested procurements were competitively sourced through tenders, standing offers and quotes. Within this context, ARTC was also focussed on achieving value for money. Even though, as observed, ARTC is not obliged to follow the Commonwealth Government Procurement Guidelines, subsequently, ARTC has sharpened its approach to Inland Rail's procurement and contract management. In addition, monthly management reporting is being enhanced.

Finally, while the Ministers' funding agreement was not concluded, detailed scope of works and milestone deliverables were developed as part of each project proposal report (PPR).

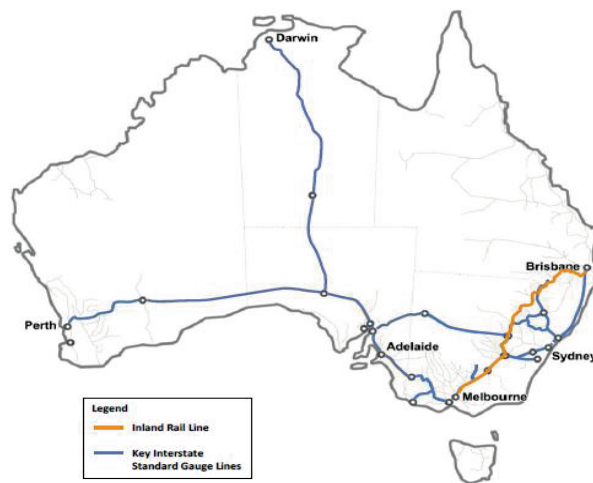
Audit findings

1. Background

Inland Rail programme

1.1 The Inland Rail programme is to construct an inland rail line from Melbourne to Brisbane, covering a total distance of approximately 1700 kilometres—constructing around 700 kilometres of new track, providing major upgrades to 300 kilometres of existing track and enhancement works on the remaining 700 kilometres. The Inland Rail programme is estimated to cost around \$10 billion over ten years.¹ Once complete, this will allow freight to be moved by rail between Melbourne and Brisbane in under 24 hours, and improve south-east Queensland’s rail link with Adelaide and Perth.

Figure 1.1: Australia’s existing rail network and planned Inland Rail connection



Source: Australian Rail Track Corporation 2015 *Inland Rail Programme Business Case*, p. 10.

Table 1.1: Inland Rail programme service offer

Inland Rail programme service offer	
Reliability	98% reliability—equivalent to that of road.
Price	Reduced rail costs for non-bulk, intermodal freight travelling between Melbourne and Brisbane of \$10 per tonne.
Transit time	<ul style="list-style-type: none">• Less than 24 hours between Melbourne and Brisbane—saving 10 hours and 200 kilometres.• A 500 kilometre reduction between both Brisbane and Perth, and Brisbane and Adelaide.
Freight availability	Freight departure and delivery when the market wants it.

Source: Inland Rail Implementation Group *Report to the Australian Government*, 2015, p. viii.

¹ Australian Rail Track Corporation, *ARTC 2015 Inland Rail Programme Business Case*, p. 2.

1.2 The business case for the Inland Rail programme notes that ‘an inland railway between Melbourne and Brisbane has been considered for more than 100 years, first being formally considered in 1902’.² More recent key studies underpinning the Inland Rail programme are shown in Table 1.2. The Inland Rail programme has also been included in Infrastructure Australia’s *Infrastructure Priority List* since May 2016.³

Table 1.2: Key studies for the Inland Rail programme

Studies, reports and funding commitments	
June 2006	<p><i>North-South Rail Corridor Study June 2006.</i></p> <p>The study examined future transport demand along the Melbourne–Sydney–Brisbane corridor. The study was conducted by Ernst & Young, Hyder Consulting Pty. Ltd. and ACIL Tasman Pty. Ltd., at a cost of \$4.3 million. The study identified a far western corridor through Parkes in western NSW as the preferred corridor for Inland Rail.</p>
July 2010	<p><i>Melbourne-Brisbane Inland Rail Alignment Study, July 2010.</i></p> <p>The study determined the optimum alignment (within the preferred corridor identified in the June 2006 study) and likely economic and financial performance of the venture. The study was conducted by the Australian Rail Track Corporation^a at a cost of \$12.7 million.</p>

Note a: With consultants: ACIL Tasman; Aurecon; Halcrow; Parsons Brinckerhoff; and PricewaterhouseCoopers.

Source: ANAO from publicly available reports, media releases and Australian Government budget measures.

Pre-construction phase of the Inland Rail programme

1.3 In September 2013, the Australian Government announced a commitment of \$300 million for the Melbourne to Brisbane inland railway, to fund activities required to get the Inland Rail programme ready to commence construction (at the completion of the activities or at a future point). Referred to as the pre-construction (or development) phase of the Inland Rail programme, it comprises detailed corridor planning, engineering design, environmental assessments and pre-construction activities, including land acquisition.

1.4 In November 2013, the Australian Government announced the establishment of the Inland Rail Implementation Group⁴, and that ‘the Australian Rail Track Corporation will, under the guidance of the Implementation Group, work with interested parties to construct the Inland Rail project through a staged 10-year schedule’.⁵

² Inland Rail Implementation Group, *Report to the Australian Government, Attachment A: ARTC 2015 Inland Rail Programme Business Case*, p. 45. Available from <https://infrastructure.gov.au/rail/inland/files/Inland-Rail-Implementation-Group-Report_0915.pdf> [accessed 4 July 2017].

³ Infrastructure Australia was established in July 2008, under the *Infrastructure Australia Act 2008*, with responsibility to strategically audit Australia’s nationally significant infrastructure, and develop 15-year rolling *Infrastructure Priority Lists*. The first *Infrastructure Priority List* was published in December 2008. The *Inland Rail Programme Business Case* was referred in September 2015 to Infrastructure Australia for independent assessment, and consequently advanced to a Priority Project from May 2016. Available from <<http://infrastructureaustralia.gov.au/projects/infrastructure-priority-list.aspx>>, [accessed 15 May 2017].

⁴ The Group was chaired by former Deputy Prime Minister the Hon. John Anderson, AO, with representatives of the Australian, New South Wales, Queensland and Victorian Governments, and the Australian Rail Track Corporation. The first meeting of the group was held in March 2014.

⁵ Media Release by the Deputy Prime Minister and Minister for Infrastructure and Regional Development, 28 November 2013: <http://minister.infrastructure.gov.au/mt/releases/2013/November/mt034_2013.aspx> [accessed 19 July 2017].

1.5 In the 2014 Federal Budget the Australian Government committed the (previously announced) \$300 million in grant funding for the pre-construction phase of the Inland Rail programme over four years (2014–15 to 2017–18), with subsequent funding provisions in the:

- 2016 Federal Budget, up to \$594 million in equity funding over three years (2017–18 to 2019–20) to progress the Inland Rail programme including land acquisition, the continuation of pre-construction, and due diligence activities⁶; and
- 2017 Federal Budget, \$8.4 billion in equity funding over seven years (2017–18 to 2024–25) to deliver the programme in its entirety.

Inland Rail Implementation Group, Report to the Australian Government

1.6 In August 2015, the Inland Rail Implementation Group presented its *Report to the Australian Government* (the report).⁷ The group had been established to:

... lead the development of a 10-year delivery programme for the Inland Rail by the Australian Rail Track Corporation (ARTC) and prepare the business case. Responsibilities included settling the alignment, determining construction priorities, commencing pre-construction and monitoring development of the programme. The Deputy Prime Minister also requested that a dedicated freight route connecting the interstate line with the Port of Brisbane be examined.⁸

1.7 The report included that the ‘Implementation Group is satisfied that Inland Rail represents a necessary, cost-effective and industry-supported response to the challenge of the growing national freight task’, noting that ‘an Australian Government decision as to whether or not to proceed with Inland Rail represents a significant and complex challenge with respect to the scale, timing and financial implications of the project’.⁹

Context for the delivery of the pre-construction phase of the Inland Rail programme

1.8 Among other things, the Inland Rail Implementation Group was tasked with providing advice on options for the expenditure of the initial \$300 million in grant funding—there were no defined objectives for the funds, other than to progress the inland rail. At finalisation of the group’s report (August 2015), \$41.2 million of the initial \$300 million had been allocated and largely spent, including on costs of developing a ten-year delivery schedule and finalising a business case.

1.9 The report provided three options for ‘how best to utilise the balance of the funds’, subject to the Australian Government deciding to: proceed to full construction in the immediate future; defer construction to a later date; or not progress the Inland Rail connection.

⁶ *Budget 2016–17, Budget Measures, Budget Paper No.2 2016–17, Part 3: Capital Measures*, p. 171. The funding will be subject to an equity funding agreement to be developed between the Commonwealth and ARTC. [As at 5 July 2017, Infrastructure advised that this funding has not been drawn upon. Available from <http://www.budget.gov.au/2016-17/content/bp2/download/BP2_consolidated.pdf>, [accessed 4 July 2017].

⁷ Inland Rail Implementation Group, *Report to the Australian Government*, in conjunction with consultants PricewaterhouseCoopers and ARTC business case.

⁸ *ibid.* p. vi.

⁹ *ibid.* p. 97.

Recommendations outlining possible alternatives for expenditure of the remainder of the \$300 million would depend on which of the three options applied.¹⁰

1.10 The report also commented that ‘the delivery model has been developed with ARTC as the delivery agent at the request of Government, and while this is a viable option, it is not the only option’, suggesting a dedicated delivery authority as one alternative.¹¹ However, on 3 May 2016 the Government announced the additional \$594 million for Inland Rail, and that the project would be delivered through the ARTC in partnership with the private sector.¹²

1.11 In effect, the Government’s key decisions about the Inland Rail programme—would the ARTC continue to have carriage of the programme, and would the rail link be completed—were finalised in May 2016 and in the May 2017 Federal Budget respectively, and had to be factored into the timing of the payment of grant funds for the pre-construction phase of the programme and the ARTC’s management of pre-construction activities.

Australian Rail Track Corporation

1.12 The ARTC was established in 1998 as part of an Australian Government reform package for rail transport¹³, with agreements between the Commonwealth and state governments to form a ‘one stop shop’ for all train operators wanting to access a standardised national interstate rail network. Initially, the ARTC managed rail lines in Victoria and South Australia (including those between Albury and Melbourne, Broken Hill to Whyalla, Adelaide to Alice Springs and Port Augusta to Kalgoorlie) experiencing substantial growth in September 2004 when it entered into a 60 year lease with the New South Wales Government to operate and maintain sections of the state’s rail lines, including the Hunter Valley freight line.¹⁴

1.13 As at May 2017, the ARTC managed more than 8500 kilometres of standard gauge track in mainland Australia¹⁵ (selling access to train operators; developing new freight business; managing capital investment in the network; managing train operations; and maintaining the rail network). The ARTC describes its services as ‘facilitating the movement of a range of commodities including general freight, coal, iron ore, other bulk minerals and agricultural products. Our network is also important in providing access for interstate and inter-city passenger services’.¹⁶

¹⁰ Inland Rail Implementation Group, *Report to the Australian Government*, p. 97.

¹¹ *ibid.*, p. xvii.

¹² Joint media release by the: Minister for Infrastructure and Transport; Minister for Regional Development; and Minister for Finance, 03 May 2016: <http://minister.infrastructure.gov.au/chester/releases/2016/May/budget-infra_03-2016.aspx> [accessed 19 July 2017].

¹³ A major rail reform package announced by the Australian Government in 1996 included the sale of government-owned train operators Australian National and National Rail, and the establishment of the ARTC to manage the sections of the interstate rail network which had been controlled by the two former organisations.

¹⁴ Australian Rail Transport Corporation, available at <http://www.artc.com.au/library/annual_report_2005.pdf>, pp. 8–11.

¹⁵ The ARTC owns, leases or has agreements in place with state governments for the various rail corridors it manages. Available at <<http://www.artc.com.au/about/network>>, [accessed 15 April 2017].

¹⁶ Australian Rail Transport Corporation, available at <<https://www.artc.com.au/about/our-history/>>, [accessed 31 March 2017].

Legislative and policy context

1.14 The ARTC is a Commonwealth company, established by the Commonwealth under the *Corporations Act 2001* and is classified as a Government Business Enterprise (GBE).¹⁷ A GBE is legally separate from the Commonwealth, but is usually linked to implementing government policy, where intervention is deemed appropriate due to: high barriers to entry; market failure (or no market at all); infrastructure investments with lower rates of return; and / or other policy considerations of Government.¹⁸

1.15 The Australian Government's relationship with GBEs is similar to the relationship between a holding company and its subsidiaries, features of which include:

- a strong interest in the performance and financial returns of the GBE;
- reporting and accountability arrangements that facilitate active oversight by the shareholder;
- action by the shareholder in relation to the strategic direction of its GBEs where it prefers a different direction from the one proposed;
- management autonomy balanced with regular reporting of performance to shareholders; and
- boards that are accountable to shareholders for GBE performance, and shareholders that are accountable to Parliament and the public.¹⁹

1.16 All ARTC company shares are owned by the Commonwealth of Australia, represented by the Minister for Finance and the Minister for Infrastructure and Transport. The Shareholder Ministers and their departments—Department of Finance and Department of Infrastructure and Regional Development respectively—have joint oversight responsibilities for the ARTC's operations.²⁰ The:

- Department of Finance's primary tasks in relation to GBE's includes to: provide sound strategic and analytical advice to the Minister for Finance, in particular by engaging with the GBEs, and ensure that there is a robust and sound governance framework in place by initiating change and contributing to policy development²¹; and
- Department of Infrastructure and Regional Development, as the Portfolio department in which the ARTC operates, has a more operational role in: ensuring that the ARTC meets the Government's policy objectives effectively; builds shareholder value and ensures the

¹⁷ GBEs may be established as an entity under a specific Act of Parliament (a Corporate Commonwealth Entity), or incorporated as a company under the *Corporations Act 2001*. There is no enabling legislation establishing the Australian Rail Track Corporation.

¹⁸ Refer to the online guide to GBEs published by Finance: <<https://www.finance.gov.au/gbe-directors-guide/framework/>> [accessed 19 April 2017].

¹⁹ Available from <<http://www.finance.gov.au/resource-management/governance/gbe/>>, [accessed 17 July 2017].

²⁰ The government typically communicates its requirements of the company through several means, including the Company Constitution; Commercial Freedoms Framework; discussion on drafts of the company's Corporate Plan and Statement of Intent; and the Minister's Statement at Annual General Meetings.

²¹ Department of Finance, refer <<https://www.finance.gov.au/resource-management/governance/gbe/>> [accessed 19 July 2017].

ongoing sustainability of the business; and utilises resources in an efficient, effective, economical and ethical manner.²²

1.17 The *Corporations Act 2001* is the primary regulatory framework for Commonwealth companies. The *Public Governance, Performance and Accountability Act 2013* (Chapter 3) sets out requirements that Commonwealth companies also have to comply with to meet appropriate standards of public sector accountability.²³ The Department of Finance maintains a resource management guideline for GBEs on board and corporate governance, financial governance and planning and reporting: *RMG-126 Commonwealth GBE governance and oversight guidelines*.²⁴

Administrative arrangements

1.18 Internal governance of the ARTC is provided through an eight-member Board of Directors²⁵ that ‘provides stewardship, strategic leadership, governance and oversight of GBEs, while acting also as a bridge between Commonwealth policy making and operational implementation’.²⁶

1.19 The operations of the company are managed through the ARTC’s Executive Committee that comprises the Chief Executive Officer (who is also a member of the ARTC Board) and other executive level managers. As at May 2017, the structure of the company reflected: legal services and corporate affairs reporting directly to the CEO; two business units, Hunter Valley and Interstate; and four support divisions providing a range of corporate services across the company. Going forward, from July 2017, the Inland Rail programme will be established as a third business unit within the ARTC, headed up by a Chief Executive Officer, reporting to the ARTC Chief Executive Officer / Managing Director and a Chief Financial Officer for the programme.

1.20 As at July 2017, the ARTC (including for the Inland Rail programme) had 1236 employees, and maintained premises in some 60 locations across Australia, including seven rest houses, 27 provisioning centres for staff working on rail maintenance, 16 sub-depots, three network control centres and six main offices.

Funding

1.21 The ARTC is funded through a combination of rail access fees charged to commercial train operators and coal producers, Australian Government equity contributions and/or direct grants related to specific capital projects, and other income (including interest revenue and insurance recoveries), shown in Table 1.3 for 2014–15 to 2016–17.

²² Available from <<https://www.finance.gov.au/gbe-directors-guide/framework/>> [accessed 19 July 2017].

²³ The ARTC’s operations are also subject to relevant state government legislation, including Work Health and Safety and land access legislation.

²⁴ Available from <<http://www.finance.gov.au/resource-management/governance/gbe/>>, [accessed 4 July 2017].

²⁵ The Board’s size and composition is subject to limits imposed by ARTC’s Constitution, which provides for a minimum of three and a maximum of eight Directors. Directors are appointed by the Shareholder Ministers in accordance with the Company’s Constitution and GBE Guidelines.

²⁶ Department of Finance, *On-line guide for GBE directors*, prepared in consultation with portfolio departments and GBEs. Available from <<http://www.finance.gov.au/gbe-directors-guide/framework/>>, [accessed 16 July 2017].

Table 1.3: ARTC income and equity funding 2014–15 to 2016–17

	2014–15 \$ million	2015–16 \$ million	2016–17 \$ million ^a
Rail access fees	758.4	755.7	713.8
Government grants	54.6	69.5	85.6
Other income	45.2	30.1	26.8
Equity injections	0.0	0.0	81.0
Total revenue and other income	858.2	855.3	907.2

Note a: Draft end-of-year results, as at 2 August 2017.

Source: ANAO from the ARTC *Annual Report 2015–16*, Consolidated Income Statement, p. 51; and information provided by the ARTC for 2016–17.

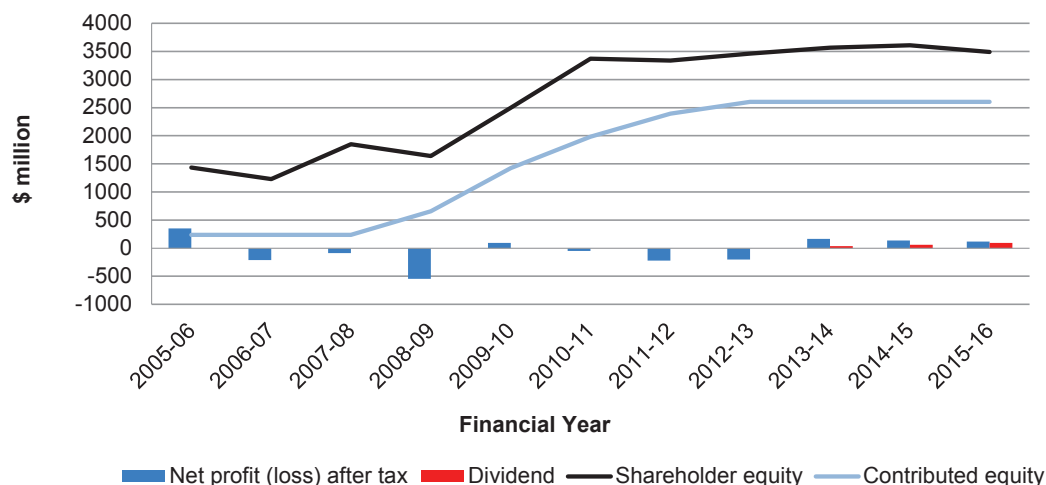
1.22 Through work funded from the ARTC's own sources of revenue, grant funding from the Australian Government²⁷, equity injections²⁸ and an agreed nine year dividend 'holiday' prior to 2013–14, the ARTC has undertaken projects to upgrade freight lines. Major projects it has undertaken include the substantive completion, in 2013–14, of a \$7 billion investment programme to repair, upgrade and expand capacity on the Hunter Valley and Interstate rail networks.²⁹

1.23 The ARTC's financial performance for 2005–06 to 2015–16, the value of the dividend paid to the Australian Government, and contributed and total shareholder equity over the same period is shown in Figure 1.2.

²⁷ From May 2004 to June 2014, the ARTC received some \$1.4 billion in Australian Government grants for various rail infrastructure projects other than Inland Rail.

²⁸ Equity injections by the Government in ARTC include approximately \$1.2 billion announced in December 2008 under the Nation Building Economic Stimulus Package and approximately \$1 billion in the May 2010 Budget to supplement this investment. These monies were received over the five years 2008–09 to 2012–13.

²⁹ Of this, an almost \$4 billion capital program to modernise the Interstate network saw completion in 2013–14 of: a new passing lane north of Melbourne; a ballast rehabilitation program between Melbourne and Sydney; and a centralised train control system between Coonamia and Tarcoola.

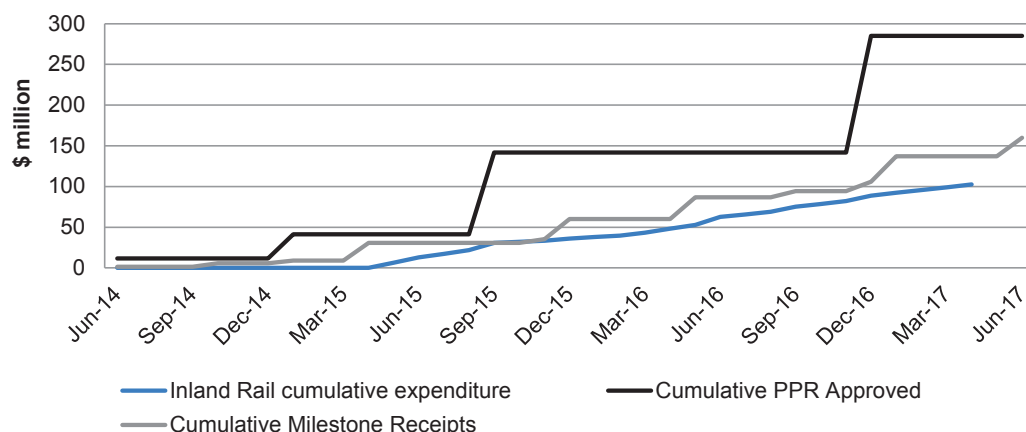
Figure 1.2: ARTC financial performance, 2005–06 to 2015–16

Source: ARTC Annual Reports, 2005–06 to 2015–16.

Funding for the pre-construction phase of the Inland Rail programme

1.24 The ARTC accesses grant funding for the pre-construction phase of the Inland Rail programme through submissions, referred to as Project Proposal Reports (that set out milestone deliverables), to the Department of Infrastructure and Regional Development. The department assesses the Project Proposal Reports and advises the Minister for Infrastructure and Transport, who then decides whether funding should be approved.

1.25 As at July 2017, the ARTC had submitted four Project Proposal Reports for the pre-construction phase of the programme of which, as at June 2017, \$285 million had been approved by the Minister, and \$160 million paid (against milestone deliverables) to the company (Figure 1.3).

Figure 1.3: Inland Rail cumulative funding and expenditure: June 2014 to June 2017

Source: ANAO, from information from the ARTC and the Department of Infrastructure and Regional Development.

1.26 The majority of pre-construction activities are being conducted through contracted services procured by the ARTC (including for engineering and design work), with an increase (as the pre-construction phase progressed) in contracting activity, governance and oversight arrangements, and ARTC personnel working on the programme. The Australian Government's commitment in May 2017 to the full Inland Rail means the pre-construction phase of the programme will not have a discrete completion date, but will merge into construction mode during 2017–18.

1.27 Achieving value for money in the expenditure of public funds should be a key consideration in all aspects of the management of the programme, including procurement activity. Finance, on its website³⁰, describes that to achieve a value for money outcome, procurements should: encourage competition and be non-discriminatory; use public resources in an efficient, effective, economical and ethical manner that is not inconsistent with the policies of the Commonwealth; facilitate accountable and transparent decision making; encourage appropriate engagement with risk; and be commensurate with the scale and scope of the business requirement.

Audit objective, criteria and approach

1.28 The audit objective was to assess whether value for money was being delivered by the ARTC's management of the pre-construction phase of the Inland Rail programme. To form a conclusion against the audit objective the ANAO examined whether:

- governance arrangements were appropriate, and administration of grant funding was effective; and
- the ARTC's procurement activities provided value for money and were supported by Information and Communications Technology systems and appropriate policies and procedures.

1.29 The audit focused on the: overarching governance arrangements for funding and delivering the pre-construction programme; and procurement activities, which have comprised the majority of the expenditure to date. The Australian Government's policy decisions to: commit to, and to fund the construction of the full Inland Rail; and deliver the programme through the ARTC are not within the scope of this audit.

1.30 In conducting the audit, the ANAO: examined relevant documentation from the ARTC, Department of Infrastructure and Regional Development, and Department of Finance; interviewed ARTC staff based in Sydney, Newcastle, Brisbane and Adelaide; and interviewed officers from the Department of Finance and the Department of Infrastructure and Regional Development based in Canberra.

1.31 The audit was conducted in accordance with the ANAO's Auditing Standards at a cost to the ANAO of approximately \$580 000.

1.32 The team members for this audit were Michelle Mant, Alice Bloomfield, David Hokin, Judy Jensen and Andrew Morris.

³⁰ Refer: <<https://www.finance.gov.au/procurement/procurement-policy-and-guidance/commonwealth-procurement-rules/march/value-for-money/>> [accessed 19 July 2017].

2. Governance and funding arrangements

Areas examined

This chapter examines the governance arrangements supporting the pre-construction phase of the Inland Rail programme, processes for providing grants funding for the programme, and the management of costs, property and staffing requirements.

Conclusion

Governance arrangements for the pre-construction phase of the Inland Rail programme were appropriate, although there was not timely implementation of the Minister's decision that a funding agreement be developed between the Department of Infrastructure and Regional Development and the Australian Rail Track Corporation. The Australian Government's longer term intent with regard to the delivery and full construction of the Inland Rail was appropriately considered, including through the administration of grant funding. There could have been more emphasis on achieving value for money in procurement and contracting activities, including for the ARTC's contracting of staff for the programme, and improved planning for the leasing of property.

Areas for improvement

The ANAO made one recommendation aimed at improving the management of risk for the Inland Rail construction programme (paragraph 2.32). The ANAO also suggested that, to support the full construction of the Inland Rail: the level of technical knowledge and expertise in the ARTC to manage the programme and that available to the government to oversight it, should be regularly reviewed (paragraph 2.18); the Department of Infrastructure and Regional Development should clarify the status of funding agreements (paragraph 2.43); and the ARTC should develop a property plan for the Inland Rail programme to ensure value for money in its office accommodation (paragraph 2.70).

Were there appropriate governance arrangements supporting the pre-construction phase of the Inland Rail programme?

Governance arrangements overseeing the pre-construction phase of the Inland Rail programme were appropriate, in so far as they adapted to the different stages of the implementation of the programme, and considered the Australian Government's interests with regard to longer term decisions about the delivery of the complete Inland Rail. There was no evidence however, that due consideration had been given to matters raised about the skills and status of committee members, specifically in relation to departmental representation. There could also have been more emphasis on achieving value for money in procurement and contracting activities. The ARTC's internal governance arrangements were appropriate, with a high level of engagement by the company's Board throughout the pre-construction phase. The ARTC is strengthening its processes to manage risk, and needs to implement a suitable system to support the management of risk in the Inland Rail programme.

2.1 To assess whether there were appropriate governance arrangements supporting the pre-construction phase of the Inland Rail programme, the ANAO examined:

- governance arrangements within the ARTC (including reporting to the Board) and between the ARTC and Shareholder Ministers' departments;
- the functioning of the ARTC's Audit and Compliance Committee; and
- the ARTC's management of risk.

Governance arrangements

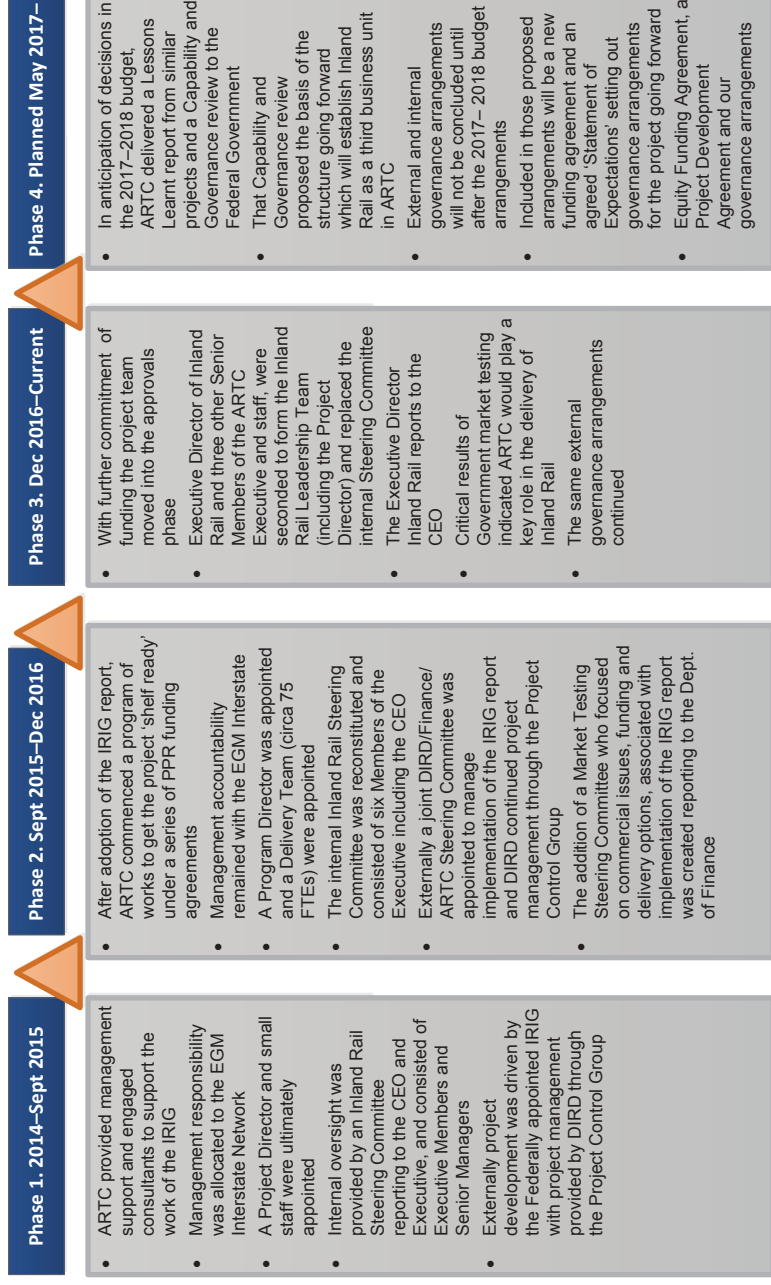
2.2 Governance of the pre-construction phase of the Inland Rail programme was provided through various groups and committees—internal to the ARTC, and jointly with the Department of Finance (Finance) and the Department of Infrastructure and Regional Development (Infrastructure). The groups and committees, and overall governance structure are illustrated in the:

- ARTC *Governance Model, Presentation to the Australian National Audit Office, 3 May 2017*, (updated 2 August 2017): governance arrangements over four phases of the Inland Rail programme (Figure 2.1); and
- Department of Infrastructure and Regional Development, *Interagency Governance Structure* (Figure 2.2).

2.3 The two figures provide a different perspective of the governance arrangements, including that the ARTC presentation shows arrangements within the company, while the Infrastructure figure only shows the joint departmental / ARTC arrangements. Eight of the groups and committees identified in Figures 2.1 and 2.2 and the periods over which they functioned, are shown in Figure 2.3. Together, these figures show that there were a number of governance groups and committees for the pre-construction phase of the Inland Rail programme.

Figure 2.1: Governance Phases for the Inland Rail programme—2014 to August 2017

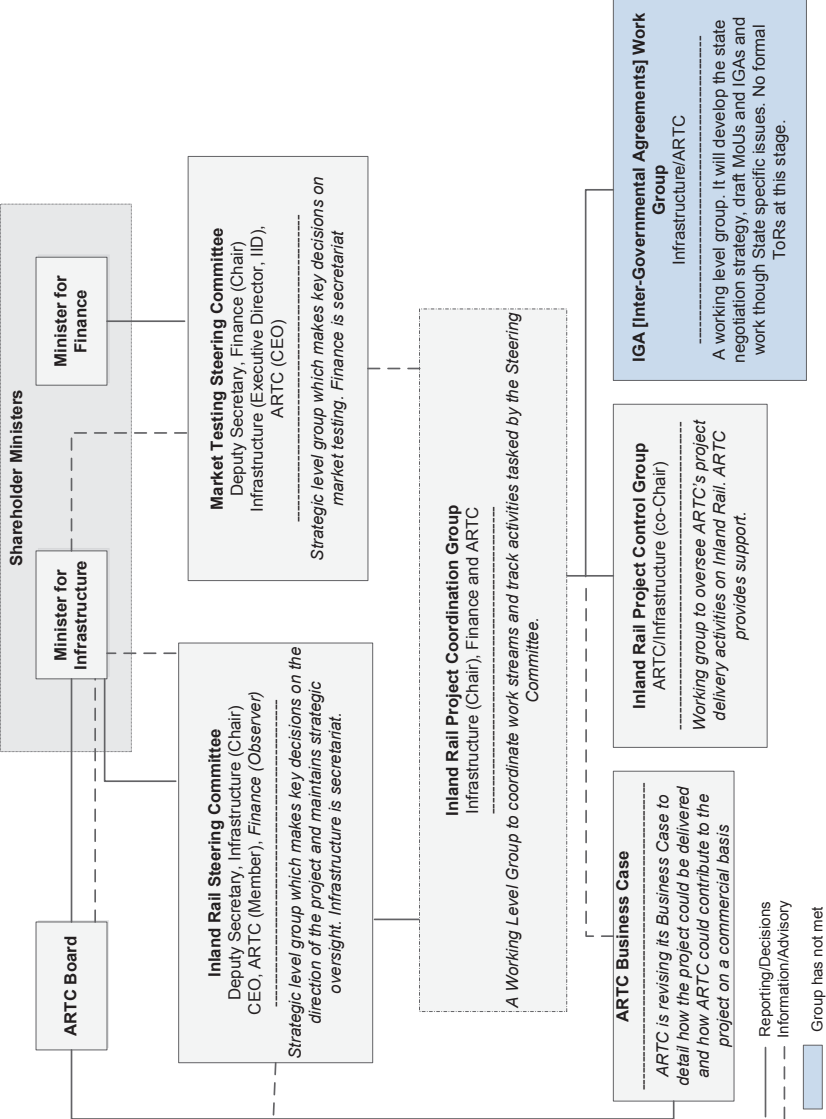
Governance Phases for Inland Rail



Note: 'IRIG': Inland Rail Implementation Group; 'EGM Interstate Network': Executive Group Manager of the Interstate Network Branch; 'DIRD': Department of Infrastructure and Regional Development (also referred to as Infrastructure).

Source: ARTC, ARTC Governance Model, Presentation to the Australian National Audit Office, 3 May 2017, updated 2 August 2017.

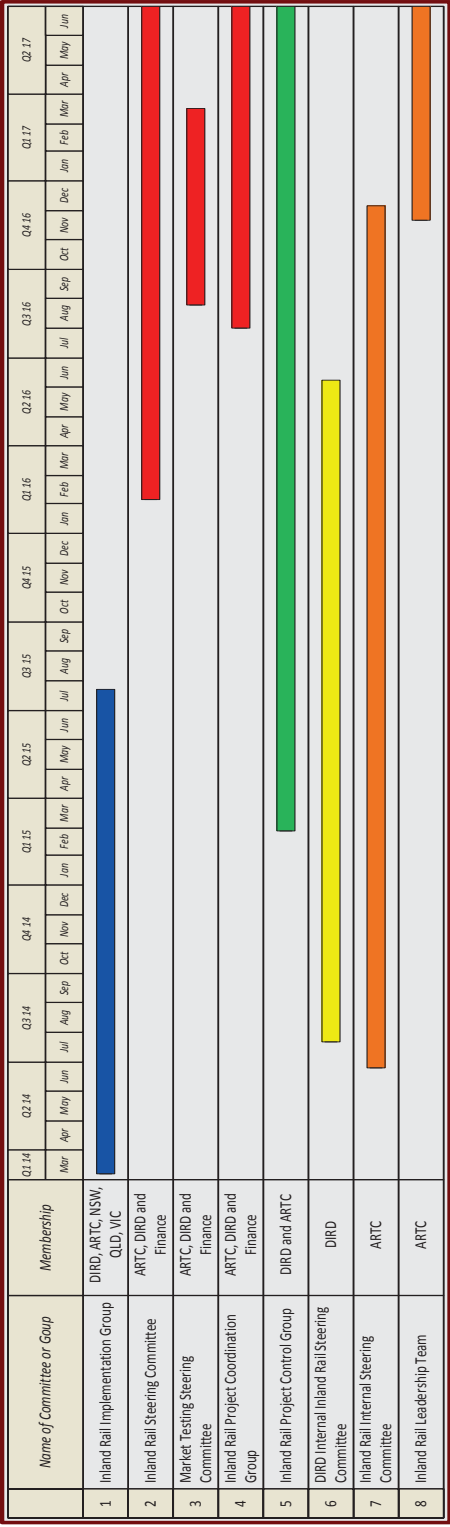
Figure 2.2: Inland Rail programme governance, May 2017



Note: As at August 2017, Infrastructure advised that the ARTC Business Case work stream was complete, and the Inter-Governmental Agreements working group commenced in late 2016.

Source: Department of Infrastructure and Regional Development.

Figure 2.3: Periods over which the governance groups and committees functioned



Note: DIRD, Department of Infrastructure and Regional Development (Infrastructure).

Source: ANAO analysis, from minutes of the meetings of each group.

2.4 The Terms of Reference for, or purpose of, each group or committee is at Table 2.1.

Table 2.1: Outline of governance groups for the Inland Rail pre-construction programme

Committee/Group	Terms of reference / purpose
Joint departmental / ARTC governance arrangements	
Inland Rail Implementation Group (10 meetings)	Established by the Deputy Prime Minister to lead the development of a 10-year delivery programme for Inland Rail by the ARTC, and prepare the business case.
Inland Rail Steering Committee (19 meetings)	Established to provide strategic direction and oversight for the Melbourne to Brisbane Inland Rail programme. Specifically, the committee will oversee the delivery of a range of activities that the government announced in the 2016 Federal Budget to ensure that the government will be in a position to make decisions about the delivery, funding and financing of the project in the 2017 Budget.
Market Testing Steering Committee (10 meetings)	Established to provide strategic oversight and guidance to the market testing, funding review and capability review (the reviews) that are being undertaken as part of the Melbourne to Brisbane Inland Rail Project.
Inland Rail Project Coordination Group (no minutes kept)	Formed as a weekly working level group to coordinate work streams and track activities tasked by the Inland Rail Steering Committee. Maintains a register of actions for the group.
Inland Rail Project (or Programme) Control Group (18 meetings)	Facilitates the delivery and provides management oversight for all phases of the Melbourne to Brisbane Inland Rail programme. Reports to the Inland Rail Steering Committee, and provides the main point of governance and programme review between Infrastructure and the ARTC.
DIRD ^a Inland Rail Internal Steering Committee (10 meetings)	Formed to provide oversight and strategic governance for the Department's role in Inland Rail, including to ensure that business objectives were adequately addressed and that the project remained appropriately resourced and on target. Meetings were suspended on 7 June 2016 with the comment that 'members can provide feedback out of session'.
ARTC internal governance arrangements	
ARTC Internal Steering Committee (35 meetings)	To assist in arranging governance of the Inland Rail programme, particularly risk and value for money.
Inland Rail Leadership Team (12 meetings)	Team created as the first stage of a transition to creating Inland Rail as a business unit within the ARTC. Role of the team set out in a Decision Process Chart, which includes the team will act as the Project Steering Committee. Met weekly by phone and monthly face-to-face.

Note a: DIRD, Department of Infrastructure and Regional Development (Infrastructure).

Source: ANAO, from documentation provided by the ARTC, Infrastructure and Finance.

Departmental oversight

2.5 The ANAO's review of the terms of reference and meeting minutes of the joint groups and committees reflected a logical progression as the programme progressed. For example:

- the Inland Rail Implementation Group (group 1³¹) ceased with the finalisation of the group's report to the Australian Government; and
- the senior level Inland Rail Steering Committee (group 2) was established to provide oversight of the programme in February 2016, following a request of the Minister for Infrastructure and Regional Development in approving \$100.6 million in grant funding for the ARTC.³²

2.6 The ANAO review also identified references to the challenges involved in effectively overseeing the programme. For example, the report of the Inland Rail Implementation Group, August 2015, included that 'Inland Rail is a complex project' and that 'effective governance will be critical to ensuring that it delivers the intended outcomes and is delivered cost effectively'. The report stated:

An important aspect is that there is an effective programme management office that has effective oversight with the necessary skills to take and be accountable for the many detailed decisions that will occur as the project is delivered. The Implementation Group recommends that the Government establish a programme delivery office for Inland Rail that has the necessary skills (including commercial, financial and technical), supported by a governance structure that is accountable for outcomes and delivery on-time and on-budget.

2.7 In a similar vein, the minutes of the last meeting of the DIRD Internal Steering Committee (11 May 2016) (group 6) record discussion about ongoing governance arrangements for Inland Rail and the need for independent expertise and advice. There was an action item 'to review governance arrangements with the assistance of an independent strategic advisor and taking into account suggestions from members of the group'. Further discussion on governance arrangements included that: members of the committee (group 6) expressed concern that the ARTC had member status rather than observer status of the high-level Inland Steering Committee (group 2), and that an independent rail expert would enhance this committee. Minutes of the high-level Inland Rail Steering Committee (group 2):

- show that the committee had two members (the Secretary of Infrastructure and the Chief Executive Officer of the ARTC) with other attendees from Infrastructure and the ARTC as 'participants' and a representative from Finance with 'observer' status; and
- do not record any participation in the group by an independent rail expert.

2.8 The ANAO review also identified that departmental oversight of ARTC's procurement and contract management could have been better. Terms of reference for the Inland Rail Project Control Group set out 11 'roles and responsibilities', of which three relate to specific aspects of

³¹ The group numbers refer to the list in the first column of Figure 2.3.

³² The Minister stated, in his letter to the ARTC of 1 October 2015, that 'I also consider that governance is a critical element of the delivery of a programme the size of Inland Rail. Consequently I ask that you work with the Department to establish appropriate governance arrangements for the ongoing delivery of Inland Rail'.

the management of procurement and contract variations.³³ A review of the minutes of 16 meetings of the group showed that contract variations were discussed in eleven meetings. The discussions did not relate to individual contracts, rather to changes to Milestone Package deliverables. ANAO testing of 54 procurements (discussed in Chapter 3) found 24 of them were varied in excess of 50 per cent of the initial contract value, and no discussion of these variations is recorded in the minutes.

2.9 Overall, the joint governance arrangements for the pre-construction phase of the Inland Rail programme were appropriate, in so far as there was good representation of senior executive and operational staff to provide oversight and strategic direction for the programme. The groups and committees also adapted in response to the progression of the programme, and managed the Australian Government's interests and longer term intent with regard to the delivery model and full construction of the Inland Rail.

2.10 There is no documented evidence, however, as to work undertaken to identify the 'appropriate governance arrangements' referred to by the Minister in 2016, or respond to the recommendation by the Inland Rail Implementation Group (group 1) to establish a programme delivery office with the 'necessary skills'.³⁴ There is also no record of consideration of securing the services of an independent rail expert, or of resolving whether the ARTC's 'membership' status at the high-level Inland Steering Committee (group 2) was appropriate, with regard to responsibilities and accountabilities of Infrastructure to oversight the programme and the ARTC Board and senior executive to implement it.

2.11 There could also have been greater oversight of the ARTC's procurement activities with respect to achieving value for money in contracting. Further, the development of a funding agreement between the Department and the ARTC (to agree project milestones and reporting arrangements) as requested by the Minister in June 2014 but not finalised until July 2017 (discussed later in this chapter), could have provided guidance on the outcomes associated with the \$300 million grant funding (other than to progress the Inland Rail programme) and accordingly on key priorities for the pre-construction programme.

ARTC internal governance arrangements

2.12 In February 2017, the ARTC advised that the internal governance process for Inland Rail:

... mirrors that set by the parent ARTC body with modification only to meet any peculiarities that may arise due to the Programme Management / Programme Delivery and Procurement Delivery Strategies that are specifically involved with this Inland Rail Programme and its Projects. ... Over the period under audit/review ... higher-level Committee, Programme and Project organisational structures have changed several times to reflect the maturing nature of the Programme as it has progressed through the lifecycle phases of the *ARTC Project Management Lifecycle*. Therefore,

³³ The three responsibilities of the Project Control Group relating to procurement were to: note all procurements and receive regular reports on all contracts with a cost greater than \$1 million; provide advice to the Inland Rail Steering Committee on any contract with a cost greater than \$5 million, prior to award of the contract; and provide advice to the Inland Rail Steering Committee on contract variations where the cost of the variation is greater than \$2.5 million, or greater than 50 per cent of the total contract budget.

³⁴ The recommendation does not clarify at what point in the Inland Rail programme that a programme delivery office should be established. Infrastructure advised in August 2017 that it regards the ARTC as the project office following the Government decision for ARTC to deliver the Inland Rail programme.

and not surprisingly, committees at the governance, strategic management and management levels have changed their function and even reporting lines during the described maturation process; the latter specifically at the higher levels.

2.13 Consistent with this advice, the ARTC advised that the internal governance body for Inland Rail changed names several times. The ARTC Internal Steering Committee (group 7) met from 25 June 2014 to 4 May 2016, when it became the Inland Rail Executive Group, which met between 27 May 2016 and 5 December 2016. Changes within the ARTC in response to the needs of the programme then led to the creation of the Inland Rail Leadership Team (group 8), to transition to a new ARTC internal structure.

2.14 The ARTC provided over 300 documents related to these internal governance arrangements. The documentation provided records of meetings (including agenda items, action items, reports and minutes) from February 2014 to March 2017. A high-level review by the ANAO of the documentation noted discussion supporting the preparation and endorsement of the ARTC's funding submissions (discussed later in this chapter).

2.15 The ARTC also provided an overview of the various means by which the company's Board was kept informed of the progress of the Inland Rail programme and had input to decision making (Appendix 2). The ANAO reviewed 10 of the quarterly reports to the Board provided by the Interstate Network, from October 2014 to February 2017. All but one of the reports (February 2017) provided a summary of progress to date on the pre-construction phase of the Inland Rail programme: key achievements for the quarter; cumulative data on funds and expenditure; planned activities for the upcoming quarter; and risks associated with the programme.

Governance arrangements for the construction of Inland Rail

2.16 As at July 2017, the Australian Government and the ARTC are developing new governance arrangements to support the full construction of the Inland Rail programme, and the (almost) \$9 billion in equity funding the Australian Government has committed to date. In response to the government's announcement in May 2016 that it would deliver Inland Rail through the ARTC, Finance's business advisor for the programme reviewed the outcomes of a capability and governance review³⁵ undertaken by the ARTC Board to assess the 'skills, corporate structure, shareholder arrangements, and capability and governance requirements in relation to the potential delivery models for Inland Rail'.

2.17 Key findings of the review, May 2017, included that: following recent recruitment to the ARTC Board, the Board has strong capabilities to provide strategic and governance oversight to the delivery of Inland Rail under delivery options outlined in the document; (for the options outlined) the ARTC executive management team will need to be augmented by the recruitment of a Chief Executive of the Inland Rail Business Unit that will report directly to the ARTC Group Chief Executive Officer and Managing Director; and ARTC is well positioned to recruit to address current

³⁵ Inland Rail Capability and Governance Review, Macquarie Capital / Herbert Smith Freehills, Draft – May 2017.

gaps in existing capability, and is better positioned to do so than if a new government entity were to be set up for Inland Rail.³⁶

2.18 The Inland Rail programme is a significant national infrastructure initiative, and governance arrangements going forward will need to ensure that: the level of technical knowledge and expertise in the ARTC to manage the programme and that available to the government to oversight it, should be regularly reviewed; and there is clarity about outcomes and deliverables throughout the full construction of the Inland Rail.

ARTC internal audit function

2.19 The ARTC advised that the company's Audit and Compliance Committee was established in June 2000, and the audit charter reviewed in 2013 to comply with the *Public Governance, Performance and Accountability Act 2013* (PGPA Act) and PGPA Rule, with the current Charter finalised in November 2016.³⁷ The results of a review of the roles and responsibilities of the audit committee, as set out in the Charter, against requirements of an audit committee under the PGPA Act and associated rules, are set out in Table 2.2.

Table 2.2: ARTC Audit Committee Charter compliance with PGPA Act requirements

Section	Requirement	Compliance
PGPA Act		
92(1)	The directors of a wholly-owned Commonwealth company must ensure that the company has an audit committee.	Yes
92(2)	The committee must be constituted, and perform functions, in accordance with any requirements prescribed by the rules.	Yes
PGPA Rule		
17(1)	The accountable authority of a Commonwealth entity must, by written charter, determine the functions of the audit committee for the entity.	Yes
17(2)	The functions must include reviewing the appropriateness of the accountable authority's: financial reporting; performance reporting; system of risk oversight and management; and system of internal control.	Yes
17(3)	The audit committee must consist of at least three persons who have appropriate qualifications, knowledge, skills or experience to assist the committee to perform its functions.	Yes ^a

³⁶ The independent review also found that ARTC's implementation of lessons from the report, *Southern Sydney Freight Line Project – SSFL Lessons Learnt Report* (August 2013) would be critical to the company's successful management of the Inland Rail programme, including that the ARTC establishes a team with adequate experience and resources, and develops an appropriate cost base for the programme.

³⁷ As a Commonwealth company, audit committee requirements for the ARTC are governed by section 92 of the PGPA Act, as well as sections 17 and 28 of the PGPA Rule. The ARTC Audit Committee Charter incorrectly refers to section 45 of the PGPA Act, which applies to Commonwealth entities. The Charter correctly refers to section 17 of the PGPA Rule (which also applies to audit committees of wholly-owned Commonwealth companies under section 28), and complies with that section (Table 2.2).

Section	Requirement	Compliance
17(4)(b)	On and after 1 July 2015, the majority of the members of the audit committee must, for a corporate Commonwealth entity, be persons who are not employees of the entity.	Yes
17(5)	The following persons must not be a member of the audit committee: the accountable authority or, if the accountable authority has more than one member, the head (however described) of the accountable authority; the Chief Financial Officer (however described) of the entity; the Chief Executive Officer (however described) of the entity.	Yes

Note a: Audit Committee members had backgrounds in the rail industry (domestic and foreign), law, accounting, engineering and government advisory.

Source: ANAO analysis.

2.20 The ARTC develops a rolling three-year plan (for safety and non-safety audits) for internal audit. The plan is delivered by ARTC internal audit staff, through outsourcing arrangements, and is also co-sourced (joint internal / outsourced resources).

Internal audit reports

2.21 Of 87 internal (non-safety) audits completed from 2014–15 to 2016–17, only one dealt specifically with the Inland Rail programme—AM14 *Inland Rail Programme Governance Framework*, March 2015. This audit, and other ARTC internal audits, raised several issues affecting the administration of the programme that have also been identified by the ANAO in this performance audit.

2.22 The AM14 *Inland Rail Programme Governance Framework* audit identified: instances of work on contracts having commenced prior to execution of the contract; and scope to improve the governance structure, which at that time involved ‘two separate governance bodies’ (the Inland Rail Implementation Group and the ARTC’s internal steering committee). Details at Appendix 3.

2.23 Other ARTC internal audit reports with findings and action items relevant to matters discussed in this ANAO performance audit (also shown in Appendix 3) are:

- IM18 *Systems Developed Outside of IT*, February 2015: focused on a review of the policies, processes, and controls implemented by ARTC to address information security. Key findings in the report included limited awareness across the ARTC of the company’s Information and Communications Technology policies and procedures;
- FIN2 *Procurement and Contract Execution*, February 2015: focused on compliance with procurement and contract procedures for the procurement of goods and services in 2014. Key findings in the report concerned the use of inappropriate types of contracts; and
- FIN01 *Procure to Pay*, 21 March 2017: assessed the adequacy and effectiveness of the controls in place to manage the risks associated with: procuring goods and services, including processes to select suppliers and the execution of contracts; and paying for goods and services. Key findings in the report included a lack of key control documentation during the tender process; a lack of justification for single source procurement; and forms signed without appropriate delegated authority.

2.24 The ARTC maintains an Audit Management System (in the form of an Access database) to record and track actions from audit findings from internal non-safety audit reports. As at July 2017, all actions from the reports listed above were recorded as 'Closed Validated' in the system.³⁸

2.25 The only audit specifically for Inland Rail in the 2016–17 work programme is AM09 *Inland Rail Project Governance Framework*.³⁹ The objective of this audit is to assess the adequacy of aspects of the Inland Rail programme's control environment, with the internal audit notice noting that 'the Inland Rail project was officially recognised as an ARTC project in April 2016, and as such the scope of the internal audit will only include the period from April 2016. As at 2 August 2017, the ARTC advised that fieldwork is being finalised for this internal audit.

ARTC risk management

2.26 At the corporate level, the ARTC has developed a *Risk Management Improvement Plan FY 2015/16 – FY 2019/20*, (RSK-PL-001) dated 18 December 2015. The objective is to ensure that risks are managed 'So Far As Is Reasonably Practicable', with six key deliverables.⁴⁰ The ARTC's strategy to deliver the plan is at Appendix 4.⁴¹

2.27 Information on the ARTC's management of risk is available on the company's intranet, *Connect*. The 'risk' intranet page provides links to key documents, including the: *Risk Management Framework*, RSK-GP-004, 26 May 2016; Risk Management Improvement Plan; and a suite of new policies and procedures, replacing seven existing documents (that are still available on the site as at July 2017, for areas of the company that have not yet transitioned to the new *Risk Management Framework*).

2.28 Prior to the development and implementation of the risk management improvement plan, in 2015 the ARTC purchased an externally supplied risk management system, with up-front costs and annual fees payable each year over a five-year contract period (to 2020), as well as additional licence costs.⁴² The ARTC advised in July 2017 that: risks are being reviewed and updated as they are transitioned from the previous system⁴³ to the current system; there have been delays in the roll out of the system; and business requirements have evolved since the initial requirements were identified in 2014.

³⁸ The 'process improvement opportunities' were also marked as 'Closed Validated' although managers are not required to act on these findings and there is no internal audit effort to validate that action has been taken. The ARTC advised that it 'had been agreed with the General Council and Company Secretary that Internal Audit will no longer track the progress to implement process improvement opportunities'. ARTC should consider changing the status description for process improvement opportunities to indicate that no follow up tracking is undertaken by internal audit.

³⁹ The ARTC internal audit advised (meeting of 12 July 2017 in Adelaide) that the forward work plan is under review to increase internal audit oversight of the Inland Rail programme.

⁴⁰ The deliverables are: enhancement of the Risk Management Framework; ensuring clear accountabilities and responsibilities for risk management; implementation and utilisation of appropriate systems to drive active risk management; provision of additional tools, techniques and guidance material; further development of organisational competencies and capabilities in risk management; and enhancement of mechanisms for governance and assurance of risk matters.

⁴¹ The plan was approved by the ARTC Board on 8 December 2015, and progress is monitored by the Executive and Board Risk Committee twice a year.

⁴² A review of the procurement documentation for the system purchased in 2015 shows that requirements of the Inland Rail programme were not considered in the procurement process.

⁴³ The ARTC previously used a Sequel database with an Access front end.

2.29 For the management of risk in the Inland Rail programme, the ARTC has developed a programme specific Risk Management Plan (drafted early in 2015 and approved 5 April 2016) and does not use the current risk management system purchased in 2015. Instead, the ARTC maintains a risk register, in the form of a macro enabled Excel workbook, with the first entry recorded on 3 October 2014. The risk register is used in conjunction with the additional tools: *Primavera Risk Analysis* and *@Risk* for Monte Carlo simulations.⁴⁴

2.30 As at 23 June 2017, over 1100 risks have been recorded in the register, of which less than 400 were still open. The ARTC advised in July 2017 that risks for the Inland Rail programme had been managed by a series of contracted risk managers, who brought their own approach and methodology to the task. As at July 2017, the current risk manager had been in the role for seven months, and had considerably enhanced the functionality and reporting capability of the register. To ensure the integrity of the register, the manager has sole edit rights to the register and has to manually manage all risk updates.

2.31 While the ARTC advised that the capability of the risk register is fit-for-purpose for the pre-construction phase of the Inland Rail programme, the company also advised that the register will not meet the needs of the full Inland Rail programme in the longer term, with greater demands placed on the risk system. The ARTC advised that discussions have begun on the way forward.

Recommendation no.1

2.32 To improve the management of risk, the Australian Rail Track Corporation accelerates the implementation of a fit-for-purpose risk management system for the Inland Rail programme.

Australian Rail Track Corporation response: *Agreed in principle.*

2.33 *At the time of procurement of the new risk system, the Inland Rail programme was not confirmed as definitely proceeding and ARTC was not confirmed as the entity to deliver the programme.*

2.34 *Therefore specific requirements for functionality, analytic capabilities and system interoperability in relation to the management of the Inland Rail programme delivery risks were not considered. Additionally, management decisions were made to keep the Inland Rail risk register separate from the ARTC business units to readily facilitate handover to another entity, in the event ARTC was not selected to deliver the programme, as was requested by Government.*

2.35 *Risk continues to be managed effectively on the Inland Rail programme. However, with the programme now funded to proceed and ARTC confirmed to deliver the programme, ARTC is currently reviewing business needs for the ongoing management of the Inland Rail programme delivery risks and developing an appropriate risk management system for use going forward.*

⁴⁴ Monte Carlo simulations are a computerised mathematical technique that facilitates accounting for risk in quantitative analysis and decision making.

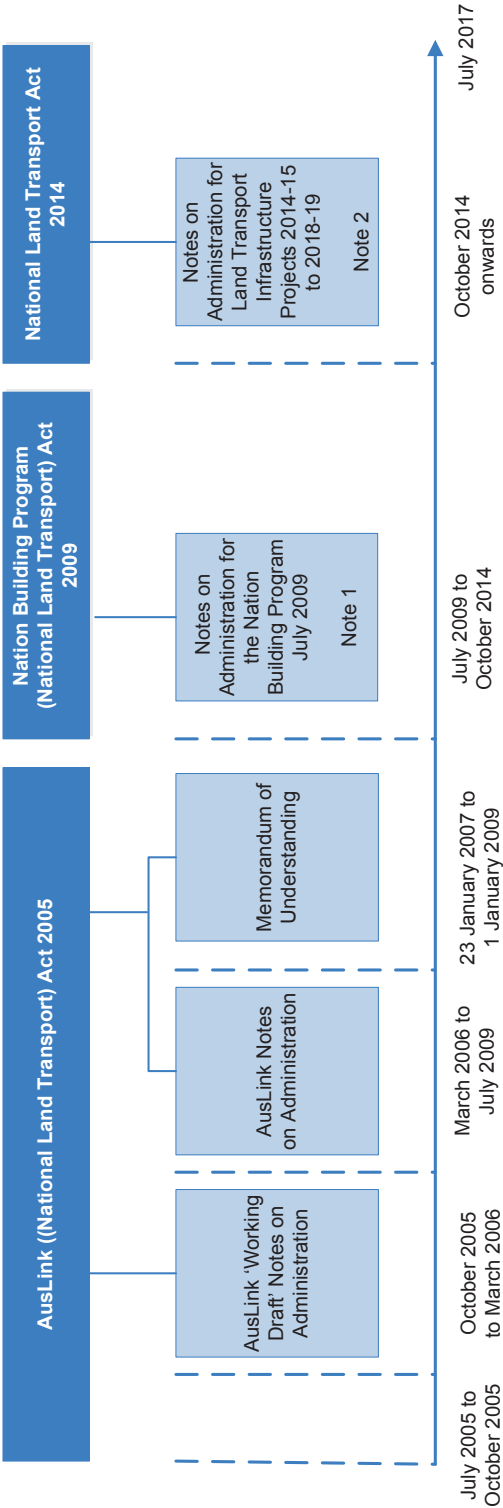
Were the grants for the pre-construction phase of the Inland Rail programme appropriately managed?

Grant funding was appropriately managed for each of the four funding packages provided for the pre-construction phase of the Inland Rail programme. There was extensive engagement between the ARTC and Infrastructure in preparing the funding submissions, and Infrastructure appropriately assessed the submissions and approved milestone delivery payments. Protecting the Commonwealth's interests centred on how best to use the funds, given the status of the project over the longer term and the ARTC's role in delivering it. However, high-level deliverables, outcomes and reporting arrangements were not developed through the Minister's required funding agreement for the pre-construction phase, which could have supported greater emphasis on obtaining value for money in procurement activities associated with the milestone deliverables identified in the grant funding submissions.

Legislative and policy context

2.36 Legislative and administrative arrangements governing the provision of Australian Government grant funding for eligible infrastructure projects, including the pre-construction phase of the Inland Rail programme, are shown at Figure 2.4.

Figure 2.4: Legislative and administrative arrangements for the provision of Australian Government grant funding for eligible infrastructure projects



Note 1: For projects funded under Parts 3 and 6 of the *Nation Building Program (National Land Transport) Act 2009* where payments are made directly to a State, an authority of a State, or any other body corporate.

Note 2: For projects funded, or proposed to be funded, under: Parts 3 or 7 of the *National Land Transport Act 2014* (NLT Act); or Chapter 2 of the *Nation-building Funds Act 2008*. The Notes apply to all Proponents and Funding Recipients, where a Proponent may be a State, an authority of a State, a Local Government Authority, or any other body corporate that submits a proposal for Australian Government funding under the NLT Act. (The ARTC is a body corporate).

Source: ANAO analysis, updating information in ANAO Audit Report No.22 2007–08, *Administration of Grants to the Australian Rail Track Corporation*, p. 37, Figure 2.1.

2.37 The *Notes on Administration for Land Transport Infrastructure Projects 2014–15 to 2018-19* (the Notes): are developed and maintained by Infrastructure; are publicly available on the Infrastructure website⁴⁵; and provide guidance for funding applicants and the administrative processes that funding recipients must follow to claim payments, including to seek variations to project approvals. Specifically, Appendices C 1-4 of the Notes⁴⁶ provide guidance on the level of detail and certainty required in a funding submission.

2.38 The Minister signed a Project Approval Instrument under Part 4 of the *Nation Building Program (National Land Transport) Act 2009* to approve the project as a National Project and provide Commonwealth funding for the project to the ARTC as the funding recipient. Subsequent funds have been approved through variations to the project approval instrument.

Funding agreement

2.39 The funding arrangement for the pre-construction phase of the Inland Rail programme between Infrastructure and the ARTC was initially outlined in an exchange of letters between the ARTC and Infrastructure, in June 2014. In a letter of 13 June 2014 (approving funds for the programme), the Minister for Infrastructure and Regional Development stated that the ARTC ‘agree with my Department through a Memorandum of Understanding or a funding agreement the project milestones as well as the reporting arrangements’. On 29 January 2015, the Minister’s letter (approving further funding) notes that the Department ‘is still in discussion with the ARTC on a Memorandum of Understanding that covers reporting obligations of grant funding...I look forward to this Memorandum of Understanding being finalised’.

2.40 A paper prepared for the ARTC Internal Steering Committee, 15 April 2015, refers to the proposed funding Memorandum of Understanding (MoU) with the Australian Government, through Infrastructure:

While the Department’s focus is likely to be on the deliverables to be provided by ARTC, the MOU will also be the instrument to ensure that risk allocation and governance arrangements between ARTC and the Australian Government is properly addressed (in particular, that risks borne by ARTC are appropriately underwritten by the Australian Government).

2.41 A formal agreement between the ARTC and Infrastructure was finalised on 7 June 2017, some three years after the Minister’s first request to develop an agreement, and in the final year of the funding for the pre-construction phase. The agreement was in the form of a Deed of Agreement (the Deed) in relation to grant funding provided to the ARTC for projects approved under the *National Land Transport Act 2014*, valid until 30 June 2019.⁴⁷ The Deed: does not provide details of project milestones and reporting arrangements (as per the Minister’s letters) referring to requirements set out in the NLT Act, the Notes and Instrument of Approval; and specifies (Clause 5.1.2) that there is no intent of retrospective application in relation to the

⁴⁵ Refer to the Infrastructure website: <<http://investment.infrastructure.gov.au/funding/projects/>> [accessed 10 July 2017].

⁴⁶ The Notes cover four project phases; Identification, Scoping, Development and Delivery.

⁴⁷ The Deed covers existing projects as set out in Schedule 3: Melbourne–Brisbane Inland Rail Preconstruction Work; Port Botany Rail Line Upgrade Stage 3; and Implementation of the Advanced Train Management System.

existing projects 'to the extent that funds have been approved in accordance with a Project Proposal Report prior to this Deed'.

2.42 Infrastructure advised on 7 July 2017, that:

There is no specific reason for the length of time the Deed took to negotiate. This funding arrangement is a binding agreement between the ARTC and the Commonwealth. It took some time to negotiate, longer than anticipated, in part due to both parties being aware of possible precedent for future construction funding.

The project (and risk) was being managed under the funding arrangements confirmed in an exchange of letters between the Department and the ARTC confirming the coverage of the funding through the Notes on Administration for the Infrastructure Investment Program.

The National Land Transport Act also provides the administrative requirements for associated projects, in particular sections in Parts 3 and 4 of the Act specify that conditions must be complied with including: reporting requirements; provision of information on request; and repayment of funds. The milestone approval arrangements required under the Notes on Administration also provided coverage from a number of perspectives including accountability and delivery of agreed outputs.

The Notes on Administration and Act manage risk and provide an accountability framework consistent with those in the Deed of Agreement.

2.43 In future, for similar grant funding arrangements, Infrastructure should more promptly comply with any request by the Minister to develop a Memorandum of Understanding or funding agreement.

Australian Government policies relating to Indigenous participation

2.44 The Deed includes that the recipient of funds (Clause 8.1) 'must, unless otherwise agreed, develop and implement Indigenous workforce strategies as envisaged in the Council of Australian Governments Indigenous Reform Circular'. As at July 2017, there is no evidence of the ARTC having developed an Indigenous workforce strategy for the Inland Rail programme, noting however, that the requirement was only recently introduced through the Deed and is not retrospective.

2.45 The Australian Government's Indigenous Procurement policy⁴⁸ took effect from 1 July 2015. It requires Commonwealth entities to award a percentage of Commonwealth domestic contracts to Indigenous enterprises.⁴⁹ As a GBE, the ARTC is not required to comply with this policy⁵⁰, but is encouraged to do so. As at July 2017 the ARTC has the first draft of a policy, *Inland Rail Programme Indigenous Procurement Policy*, September 2016, with the purpose 'to accompany Request for Tender Documents'. As at July 2017, the policy was still in draft form and there is no evidence in any of the 54 contracts reviewed by the ANAO (discussed in Chapter 3) of the consideration of Indigenous participation in procurement processes.

⁴⁸ Available from <<https://www.pmc.gov.au/resource-centre/government/commonwealth-indigenous-procurement-policy>>, [accessed 10 July 2017].

⁴⁹ The target set in the Policy is 0.5 per cent by number of domestic contracts in 2015–16, increasing to 3 per cent from 2019–20.

⁵⁰ Section 1.4 of the Policy states that Commonwealth entities that are not required to comply with the Commonwealth Procurement Rules are encouraged to use best endeavours to apply this policy.

Process for grants funding of the pre-construction phase of the Inland Rail programme

2.46 To access grant funding for the pre-construction phase of the Inland Rail programme, the proponent (the ARTC) submits a project proposal report (PPR) to Infrastructure for a tranche of the total funds available (\$300 million). The PPRs reflect specific bundles of work and set out milestone deliverables. Infrastructure assesses the PPRs and advises the Minister for Infrastructure and Transport who then decides whether funding should be approved. Infrastructure subsequently has responsibility for approving the milestone payments.

2.47 As at June 2017, the ARTC had submitted four PPRs (comprising 13 milestones) for the pre-construction phase of the Inland Rail programme. A review of the ARTC's PPRs reflects that the company followed the relevant guidance for submissions under Part 3 of the NLT Act (although PPRs 1 and 2 were approved under Part 4 of the Act).

2.48 The PPRs and amounts approved and actually paid (as at July 2017), are set out in Table 2.3. The table shows minor adjustments for potential tax obligations and unspent risk contingency funding, and variations to the approved timeframe that resulted in differences between funds requested and approved. As at July 2017, the Minister has approved all the funds requested, and the ARTC has received some \$160 million, or just over 53 per cent of the total amount of grant funding available.

Table 2.3: ARTC Project Proposal Reports and approved funding, as at July 2017

PPR submitted	Requested (\$million)	Approved (\$million)	Approval legislation	Cumulative approved (\$million)	Amount paid (\$million)	Payment date
April 2014 PPR 1 (1–3)	9.00	11.7 ^a 12 June 2014	NLT Act Part 4, s.29	11.7	1.3	25 June 2014
					4.4	27 Oct. 2014
					3.3	22 Jan. 2015
24 Nov. 2014 Variation to PPR 1	3.2 ^b	3.2 29 Jan. 2015	NLT Act Part 4, s.29	12.2 ^c		
11 Dec. 2014 PPR 2 (4–5)	29.0	29.0 29 Jan. 2015	NLT Act Part 4, s.29	41.2	21.9	28 April 2015
					4.4	22 Nov. 2015
21 Aug. 2015 PPR 3 (6–11)	235.4	100.7 1 Oct. 2015	NLT Act Part 3, s.9	141.9	24.7	22 Dec. 2015
					26.8	23 May 2016
					7.3	28 Sep. 2016
					11.8	22 Dec. 2016
					31.1	23 Jan. 2017
18 Nov. 2016 PPR 4 (9–13)	147.9 ^d	143.1 ^e 20 Dec. 2016	NLT Act Part 3, s.9	285.0	22.9	22 June 2017
Total PPRs	424.5^f	287.7		285.0^g	159.9	

Note a: The Minister approved an additional \$2.7 million for company tax obligations (taking the total to \$11.7 million) to be released 'only when ARTC demonstrates liability for tax associated with the Inland Rail project funding'.

Note b: The ARTC advised the Minister that the variation to PPR 1 was necessary to account for a number of under and overspends in relation to the original PPR 1 budget, as well as significant additional scope not envisaged at the time of the original submission.

Note c: The variation to the Project Instrument did not include the \$2.7 million allowance for tax obligations approved as part of PPR1.

Note d: As the Minister approved the full scope of work proposed in PPR3 (for delivery by September 2017), but only sufficient funding for activities to 30 June 2016, the PPR 4 submission included a revised work programme for pre-construction activity to be delivered by November 2018 and an additional \$12 million.

Note e: The PPR 4 submission included a total Risk Contingency of \$10.1 million, which included \$4.8 million brought forward from the unused PPR 3 Risk Contingency. The amount approved was adjusted accordingly.

Note f: Totals the amounts submitted by the ARTC, but does not allow for the partial funding of PPR3.

Note g: The discrepancy of \$2.7m with the approved total is accounted for by the exclusion from subsequent variations to the Project Instrument of an allowance for tax obligations as detailed at Notes 1 and 3 above.

Source: ANAO from ARTC and Infrastructure documentation.

2.49 The document control sheets attached to each of the ARTC's PPRs should set out the internal responsibilities for preparing, approving and endorsing the submissions. As shown in Table 2.4, the document control sheets did not provide full details in three of the four PPRs.

Table 2.4: Information provided on ARTC's document control sheets for each PPR

PPR	Prepared	Approved	Date approved	Endorsed
PPRs 1 and 2	No document control information ^a			
PPR3	Government Commercial Relations Manager – Inland Rail	Executive General Manager, Interstate Network	21 August 2015	Internal Inland Rail Steering Committee ^b
PPR4	Government Commercial Relations Manager – Inland Rail	Inland Rail Programme Director	blank	blank

Note a: The ARTC advised that PPRs 1 and 2 were approved by the ARTC Chief Executive Officer; and PPR 4 was considered by the ARTC's Internal Steering Group on 27 October 2016 and approved on 18 November 2016.

Note b: Evidenced in the documentation provided by the ARTC (refer paragraph 2.14).

Source: ANAO, from the ARTC's PPR submissions, and ARTC.

2.50 Guidance for Infrastructure's assessment of the PPRs is provided in the department's:

- *Practice Direction, Milestones (November 2014)*: provides project officers with guidance on the establishment and management of Milestones; and
- *Project Proposal Report Assessment Guide* (developed December 2015, and implemented the following year for assessment of PPR 4): in the form of a template that provides a record of a project officer's assessment, and follows Appendix C to the Notes. It provides a comprehensive checklist of the consideration of requirements for Land Transport Infrastructure projects.

Submission and assessment of the Project Proposal Reports

2.51 PPRs 1 and 2 are relatively simple submissions and assessments, relating to the development of discrete plans and strategies, and account for the \$41.2 million referred to in the Inland Rail Implementation Group, *Report to the Australian Government*, 24 August 2015.

Infrastructure assessed the PPRs under Part 4⁵¹ of the *Nation Building Program (National Land Transport) Act 2009* and the *National Land Transport Act 2014* respectively, and (for PPR1) the *Financial Management and Accountability Regulations 1997*.

2.52 The assessment for PPR 1 includes that the Department ‘considers the proposed expenditure is in accordance with FMA Regulation 9⁵² [and] that the PPR provides sufficient detail for the scope of works and that on the available evidence, the project provides value for money’. There is no reference to value for money in the PPR 2 assessment. The assessments by Infrastructure refer to supporting documentation provided by ARTC as part of the PPR submissions, but no analysis of these documents supporting Infrastructure’s assessment was referenced.

2.53 The ARTC’s PPR 3 is a more complex submission for a range of activities to be funded under the total remaining funds (\$235 million to September 2017), recommending one of the four options set out in the submission that, in the ARTC’s view, represents the ‘best value for money’ as ‘multiple development activities can be procured and staged along the entire rail alignment’.

2.54 Infrastructure’s engagement with the ARTC in the preparation of PPR 3, formal assessment of the submission and advice to the Minister reflect two key considerations regarding the funding of the Inland Rail programme: would the government progress the full programme; and would the ARTC be the delivery body. The advice to the Minister includes: ‘The decision to fund this PPR should ideally be made after Government has made a decision to fully fund the programme over 10 years, and determined the delivery model’.

2.55 The assessment: supports the ARTC’s preferred option (seeking up to \$235.4 million over twenty-four months, from October 2015 to September 2017), to progress further ‘Development Phase’ activities on the Inland Rail programme; but recommends only partial funding of \$100.7 million, to facilitate works that are programmed to the end of 2015–16 as ‘such an arrangement would mitigate funding risks should the government decide to use another delivery body for the project, and minimises termination costs if the Government decides not to proceed to construction’.

2.56 The Minister accepted the Department’s recommendation, advising in his letter to the ARTC of 1 October 2015 that the company should restrict entering into any contracts beyond July 2016. This restriction was subsequently lifted in a Ministerial letter of 5 May 2016, following results of the government’s scoping study, which found that retaining ARTC for the delivery of Inland Rail

⁵¹ Part 4 of the NLT Act deals with transport development and innovation projects that, at section 30(a), relate to planning, research, investigations, studies or analysis of matters related to the present or future development and usage of the National Land Transport Network. Infrastructure assessed PPR1 and PPR2 under this section as the Inland Rail programme was not part of the National Land Transport Network at that time. PPR3 and PPR4 were assessed and approved under Part 3 of the NLT Act, relating to the construction of an existing or proposed railway, once Inland Rail was approved as an Investment Project. All PPRs were, however, prepared by ARTC under Part 3 of the Act.

⁵² Regulation 9 of the *Financial Management and Accountability Regulations 1997* requires that proposals to spend public money not be approved unless the approver is satisfied, after inquiries, that giving effect to the spending proposal would be a proper use of Commonwealth resources (within the meaning given by subsection 44(3) of the *Financial Management and Accountability Act 1997*). Section 44(3) defines ‘proper use’ as the efficient, effective and ethical use that is not inconsistent with the policies of the Commonwealth.

best meets the Government's policy and budgetary outcomes. (However, the Australian Government's commitment to the full Inland Rail programme was still undecided at this time).

2.57 The ARTC's PPR 4 submission revised the programme of work for pre-construction activity to a final delivery date of November 2018 (as the Minister had approved the full scope of work proposed in PPR3 for delivery by September 2017, but only sufficient funding for activities to 30 June 2016). (The ANAO notes that milestone deliverables between PPR3 and PPR4 could not be readily reconciled: milestones were simplified; deliverables revised; timeframes for delivery amended; and payment amounts adjusted to reflect an overall increase in estimated cost).

2.58 The assessment of PPR 4 is based on Infrastructure's *Project Proposal Report Assessment Guide*, and is more structured than previous assessments. Obtaining 'value for money' is not stated specifically, but the assessment considers the project rationale against criteria set out in s.11 of the NLT Act to determine its appropriateness for funding, including the results of any assessment of the efficiency, integration, security or safety of transport operations. The department concluded that funding was appropriate under the Act on the basis of the project's inclusion in Infrastructure Australia's Infrastructure Plan as a priority project.⁵³ In its brief to the Minister, the department stated that it was satisfied that the PPR:

represents a proper use of relevant money in line with the PGPA Act and that the requirements of the NLT Act have been met. The Department has appropriate governance and administrative arrangements in place with ARTC to oversee the expenditure of funding and administration of the project.

Assessment of milestone deliverables

2.59 As at 14 July 2017, Infrastructure has made 11 'milestone' payments to the ARTC in relation to the pre-construction phase of the Inland Rail programme (Table 2.3). In relation to these milestone payments, Infrastructure provided numerous documents comprising correspondence with the ARTC, departmental briefs, file notes, assessments and signed approvals for payment.

2.60 Four of the eleven payments were supported by comprehensive assessments of associated milestone deliverables. Of the remaining seven payments: three were considered not to require assessment⁵⁴; and there was minimal documentation of the remaining four assessments, with Infrastructure noting in one of them that, 'While the rigour of the underlying work is difficult to assess on the basis of the documents by themselves, the reports appear to be comprehensive'.

2.61 An ANAO review of two of the four comprehensive assessments: \$4.4 million (paid 27 October 2014); and \$7.3 million (paid 28 September 2016) showed:

- for milestone payment on 27 October 2014: Infrastructure conducted a comprehensive review based on the three strategy papers the ARTC delivered under the milestone. Infrastructure summarised the content of the strategy papers and assessed them against

⁵³ The department further stated in its assessment that 'Inland Rail has a broad range of strategic benefits that were identified in the project Business Case and assessed by Infrastructure Australia prior to the project being included on the Infrastructure Priority List. The Project has a positive benefit cost ratio of 2.62. This means the benefits of Inland Rail (under this scenario) are approximately 2.6 times the cost.'

⁵⁴ One payment was made on approving PPR1, and two payments were contingent on the approval of PPR3 and PPR4.

its view of what was expected to be demonstrated by the ARTC in developing the strategies. The assessment was attached as an appendix in narrative form to the recommendation, as were the strategy papers; and

- for milestone payment on 28 September 2016: the assessment brief stated that Infrastructure's assessor accepted 'the Milestone deliverables, however due to the large volume of material provided and the capacity of my Section, as previously agreed with ARTC, do not endorse the content. I therefore recommend payment of \$7.349 million to ARTC.' The assessment brief included a list of documentation provided separately, but did not include the documentation or the assessment analysis.

2.62 Infrastructure engaged with the ARTC in preparing the milestones and then assessed the achievement of the milestones. This provided a second level of scrutiny of grants funding, allowing that: in some instances, funds are paid in advance; there are numerous variations to deliverables and their timing; and a comparison between PPR3 and PPR4 milestone submissions indicated proposed milestone deliverables were varied significantly.

2.63 The assessment of the milestone payments, combined with Infrastructure's engagement with the ARTC in preparing and assessing the PPR submissions, the submissions and milestone assessments, provided an appropriate framework for the grants process. There is, however, minimal reference to obtaining value for money in the activities set out in the PPR submissions and assessments, and where it is referenced, it is not clear as to how it was measured. Rather, protecting the Commonwealth's interests and obtaining value for money centred on how best to use funds, given the uncertainty as to the status of the project over the longer term, and to the ARTC's role in delivering it.

2.64 The note in the milestone assessment (paragraph 2.58) concerning the resources within the department to endorse the material provided by the ARTC, reflects similar comments to references about governance of the Inland Rail programme, referring to the 'necessary skills' and 'independent expertise and advice' to effectively oversee it. Going forward the government will need to consider the extent to which it relies on the ARTC to appropriately expend the equity funding provided for the full construction of the Inland Rail, and the level and capacity of departmental oversight of the expenditure.

Has the Australian Rail Track Corporation effectively administered costs, property and staffing requirements for the pre-construction phase of the Inland Rail programme?

The ARTC has maintained separate costs for the pre-construction phase of the Inland Rail programme, from commencement of the programme in 2014. These costs were more effectively administered some two years into the programme, with the implementation in August 2016 of upgrades to the company's financial management system that allowed more detailed allocation and monitoring of costs. The ARTC has secured additional office accommodation for staff in the Inland Rail programme, but in the absence of a property plan for the programme or for the ARTC's property needs more broadly, it cannot be assured that it is achieving value for money in leasing costs. Similarly, staffing requirements for the programme have been met through contracting arrangements for specialist staff, but with no forward plan as to the requirements of the programme. However, these arrangements have provided flexibility in recruitment, and will likely be a source of workforce skills in the longer term. The ARTC needs appropriate procurement processes in place to ensure transparency and value for money in securing contracted staff, as in all other contract arrangements.

Administration of costs

2.65 The ARTC has maintained separate costings for the pre-construction phase of the Inland Rail programme from March 2014, although the system and chart of accounts for the costs has changed as the programme progressed. A review of the monthly Inland Rail Project Summary Report for April 2017 reflects this change, with some 1260 unique cost codes at April 2017, identified by project phase, funding package, area and activity. This is an increase from the 83 discrete cost codes in use from commencement of the programme in March 2014, until the implementation of the Works Management Module in the ARTC's financial system (CI Financials) in August 2016.⁵⁵ The ARTC advised that:

Initially for PPR1 & PPR2 [funding submissions] cost analysis of the identified costs were rolled up under Programme Management and ultimately up into the Project Director Cost group. As the Programme matured, and in particular for PPR3 expenditure, more detailed cost codes were introduced into the WBS [Work Breakdown Structure] and Chart of Accounts to provide the necessary granularity around expenditure and, where appropriate, direct costs attributable to a particular project were captured directly to the project rather than through the Programme management code. Hence why there is a mixture of expenditure captured directly and indirectly.

2.66 Changes to the cost codes means that costs allocated to cost centres prior to the expansion of the chart of accounts have not subsequently been re-allocated to reflect this increased granularity of reporting, with reduced detail in relation to the reporting of expenditure on the programme. For example, as at April 2017, cumulative costs of \$1.1 million in 'Office Costs'

⁵⁵ The ARTC advised: 'The use of the Works Ledger was fit for purpose during this period, however, as the project matured/progressed, funding became more certain and the complexity of management increased an appropriate business case for the implementation of the Works Management Module was developed and approved. This facilitated the purchase of additional modules within the Ci Financials Suite to support the financial management and the increasing complexity of the project. The Works Management Module was implemented in August 2016'.

and \$11.1 million in 'Consulting Support' do not include costs (in these categories) previously allocated to 'Project Director Inland Rail staff costs' of \$1.1 million and \$29.5 million respectively.⁵⁶

Property and staffing

Property

2.67 The ARTC is a national, decentralised operating company that deploys staff in Regional Australia to operate and maintain railway. In May 2017, the ARTC provided a list of 70 locations where it owns⁵⁷ or leases property. The property includes rest houses and provisioning centres for staff working on specific sections of rail, and 'administration offices', including in Sydney, Melbourne, Newcastle, Adelaide and Brisbane. For the period 2014–15 to 2016–17, the ARTC paid approximately \$8.5 million (\$2.5 million, \$2.9 million and \$3.1 million respectively) in leasing costs for provisioning centres and administration offices across the organisation.

2.68 As at June 2017, the ARTC employed several property managers. Four regionally based staff report to a property manager based in Newcastle with responsibility for supporting the property needs for the Interstate and Hunter Valley divisions. Also, a property manager for the Inland Rail programme reports to senior staff in the Inland Rail programme team in Brisbane.

2.69 Office accommodation for the Inland Rail programme in Brisbane was expanded in early 2016. An (untitled) ARTC paper finalised on 1 December 2015 (approved by the Project Director for Inland Rail) examined 'various alternatives that exist for office accommodation for staff required for the Melbourne to Brisbane Inland Rail Programme'. Recommendations in the paper relating to leasing office space at specific city centre addresses in Brisbane were accepted and approved by the Executive General Manager Interstate Division, on 10 December 2015. No business case was developed to support the Project Management Office being transferred to Brisbane⁵⁸, or the subsequent expansion of the office space available.⁵⁹

2.70 The ARTC's property needs are diverse. Development of a corporate property strategy or plan that would include the future property needs for the Inland Rail programme would support the company in achieving value for money in its office accommodation.

⁵⁶ The ARTC advised, 2 August 2017, that the Works Management Module is being used in another rail project, with the intent that it will be utilised on other large projects, but did not explain why it had not been introduced previously, given the benefits in cost reporting.

⁵⁷ The ARTC advised that the majority of premises it owns were vested in it as part of the original Australian National Railways Commission asset transfer at corporatisation. The ARTC subsequently advised, in September 2017, of 60 locations where it owns or leases property.

⁵⁸ The Project Management Office was initially based in Sydney.

⁵⁹ The ARTC is developing an office accommodation strategy for the Inland Rail programme that, among other things, aims to provide: an overarching strategy for office accommodation needs within Inland Rail; and a potential integration strategy with existing ARTC accommodation facilities. As at 27 June 2017: drafts of the Inland Rail accommodation strategy were issued for comment on 3 December 2016, 21 February and 28 April 2017, and remained in draft form; and the ARTC did not have a company-wide property plan or strategy.

Staffing

2.71 The ARTC's staffing requirements for the Inland Rail programme increased as the pre-construction phase progressed. As at 28 June 2017, the Inland Rail programme had: 57 full time employees, 52 consultants from 32 consultancy companies; and some 77 contracts with consultants have expired. The predominance of contracted consultants has provided flexibility in the workforce as the programme progressed, specifically given the uncertainty as to the future of the programme and ARTC's role in delivering it.

2.72 Achieving value for money in contracting staff for the Inland Rail programme would rely on accurate assessment of the skills and capabilities required at different times and sound procurement processes. One procurement for an individual contractor's services was included in the sample of 54 procurements examined by the ANAO (discussed in Chapter 3).

2.73 A timeline of the contractor's engagement by the ARTC is shown in Appendix 5. It shows a number of variations and changes to the contracted arrangements between July 2014 and April 2017, and a corresponding increase in the contract value. The contract commenced at \$180 000, was varied seven times to \$820 000, with a cumulative value of \$1 000 000 at closure of the contract, representing a 456 per cent increase from the initial contract value. The ARTC advised that this contractor had previously been procured on competitive market rates, and his knowledge of the programme, and the uncertainties associated with the programme meant that bringing a new resource in would not have been prudent.

2.74 Allowing that contractors have specific skills required by the ARTC at different times, the company must ensure that appropriate procurement methods are applied and that value for money is obtained in procuring contractor services.

3. Procurement

Areas examined

This chapter examines the effectiveness of the Australian Rail Track Corporation's (ARTC's) Information and Communications Technology (ICT) systems, and policies and procedures supporting procurement for the pre-construction phase of the Inland Rail programme; and whether procurement activities have provided value for money, including consideration of competition in selection processes.

Conclusion

Testing of a sample of 54 procurements for the Inland Rail programme found a lack of consideration given to competition in the early phase of the programme, where a considerable proportion of procurements (17 per cent of the sample) were sole sourced. Procurement activities improved during the sampling period, as new systems, processes and practices were implemented. The ARTC's established ICT systems and procurement and document management processes and practices were well short of the needs of the Inland Rail programme. The ARTC is further reviewing its procurement policies and procedures and supporting business functions for the full construction of Inland Rail.

Areas for improvement

The ANAO made two recommendations aimed at improving the company's records management (paragraph 3.14), and ensuring transparency and consideration of value for money in procurement is at the centre of contracting activity (paragraph 3.32).

Did the ARTC have appropriate Information and Communications Technology systems to support procurement for the pre-construction phase of the Inland Rail programme?

The ARTC did not have appropriate ICT systems to support procurement for the pre-construction phase of the Inland Rail programme. There was a heavy reliance on manual processes, paper-based approvals and non-standardised records management procedures. As at July 2017, specifically for the Inland Rail programme, the ARTC has upgraded the Contracts module and implemented a Tenders management module in the corporate Financials & Supply Chain system, and is at an early stage in deploying a system for records management. These improvements, if fully bedded down, with intended functionality being utilised and supported by updated procedural documentation, would strengthen the Inland Rail programme's procurement processes and records management, and could have application more broadly across the ARTC.

3.1 To assess whether the ARTC had appropriate systems to support procurement and contract management for the pre-construction phase of the Inland Rail programme, the ANAO assessed the ARTC's management of ICT systems, and records management practices.

Management of ICT systems

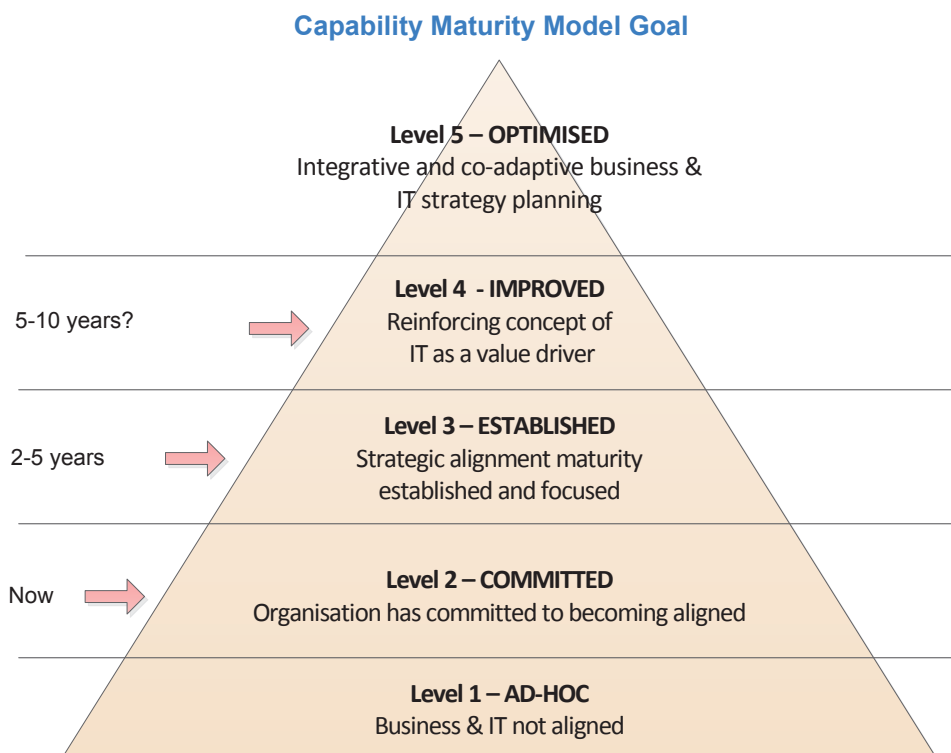
3.2 The ARTC internal audit report, *IM18 Systems Developed Outside of IT*, February 2015, reviewed the ARTC's management of its ICT systems (refer Appendix 3):

As at November 2014, over half of the systems recorded in the Application Register were managed or supported outside of the Enterprise Services Systems and Technology group. This increases the risk that insufficient controls are built into the system and non-compliance with ARTC's systems development, change management and user access management practices.

3.3 The audit report also included that, 'the agreed actions from the November 2011 *IM18 IT Systems Developed and Managed Outside of Information Technology and Systems* report have been implemented and closed, however ... the findings from this report are similar and hence those or similar actions now need to be repeated'.

3.4 In November 2014, the ARTC appointed a new General Manager, Systems and Technology, and the ARTC Board endorsed in November 2015, a Systems and Technology Road Map: a five year strategy to renew and reform ARTC's management of its ICT systems. The Road Map (Appendix 6) identifies a series of projects that introduce new technologies, transform other technologies and identify cost savings. The strategy also provides the ARTC's systems and technology capability maturity model, as at October 2015 (Figure 3.1).

Figure 3.1: ARTC Systems & Technology's Capability Maturity Model, as at October 2015



Source: ARTC Systems and Technology Road Map.

3.5 Specifically, the strategy aims to address the ‘shadow’ systems (identified in the 2011 and 2014 internal audits) where systems and applications were purchased and used without references to the required corporate procedures, and to establish the role of ARTC’s ICT division in supporting the company’s business. An ARTC internal audit report, *IM04 IT Governance and Strategy* July 2016, reviewed progress against the Systems and Technology Roadmap and noted that there had been progress in consolidating disparate processes and improving the governance processes within Systems and Technology.⁶⁰

Systems supporting the pre-construction phase of the Inland Rail programme

3.6 The document, *Inland Rail Business Systems User Requirements Specifications* (0-9000-PMA-00-SP-001-Rev 0) issued 8 December 2016 ‘defines the business requirements for the Inland Rail Programme Office relating to the initiation, planning, control, forecasting and performance reporting on projects’. Consistent with issues previously identified (Chapter 2) concerning the systems supporting the Inland Rail programme’s management of risk and project accounting, the document states that:

Inland Rail management recognise that the current state of ARTC IT systems is a contributing factor to the ongoing debate about how programme controls should be implemented and then governed, which systems should be used, their purpose, and overall application within the Inland Rail Programme and applied to its Projects. The Programme Office requires systems that will optimise its core programme controls processes and provide faster, integrated and more appropriate management information with which to manage projects effectively, reduce risk whilst at the same time increasing productivity using available resources. There are currently no standardised solution maps in place that could be readily applied. The programme is charged with developing a solution in isolation. This approach has some inherent risks.⁶¹

3.7 An ANAO review of the ICT systems used by the ARTC for document and records management (and the associated policies and procedures) explains the difficulty the Inland Rail staff had in providing many of the documents requested in the course of the audit (including for testing purposes of procurement activities, discussed below), and in maintaining version control of policy and planning documents being developed.

Document and records management

Systems

3.8 The systems the ARTC has used for document and records management since commencement of the Inland Rail programme, were:

- ‘Sharepoint CONNECT’ is the ARTC’s intranet site. Each project, including Inland Rail, has a site linked to the main page where staff can access policy and procedural documents. The site for the Inland Rail programme is available although has limited information;
- the shared ‘W’ network drive is the primary repository of all Inland Rail programme procurement and contract related documents;

⁶⁰ ARTC, *IM04 IT Governance and Strategy Audit Final Report*, July 16, pp. 3–4.

⁶¹ ARTC, *Inland Rail Business Systems User Requirements Specifications* v2.0, 8 December 2016, p. 8.

- HP TRIM (version 7.23⁶²) is the ARTC's electronic document and records management system and is used by the Inland Rail team to store the following contract documents: Contract Start-up, Approval to Release, and Approval to Amend and Variation Order.⁶³ The requirement to have copies of these documents in HP TRIM was to provide access to the ARTC Procurement team based in Newcastle, in line with ARTC's procedures. Since August 2016 the procurement function for the Inland Rail programme does not directly involve the ARTC procurement team, with the establishment of a Commercial team for the Inland Rail programme, although instructions and the practice have not changed by July 2017; and
- Ci Financials (the ARTC's financial & supply chain system) contracts module—the Approval to Release and Executed Contract forms are also attached to the contracts module.

3.9 In summary, there was no single ARTC policy for document and records. In regard to Inland Rail, some documents were stored in multiple systems and some existed only in hard copy. As at July 2017, management of the Inland Rail programme advised that they intended to deploy Aconex⁶⁴ as the principal document management system for the programme, later advising that: implementation of Aconex (as the Inland Rail programme's document management system) commenced on 4 August 2017; and that a new Quality, Systems and Audit function was established in June 2017 (reporting to the Inland Rail Programme Commercial Manager) to focus on the management of documents.

Policies and procedures

3.10 ARTC policies and procedures supporting document and records management, and others developed specifically for the Inland Rail programme, are:

- ARTC Corporate Records Management Policy (policy PPP-03 drafted November 2004 with final version 16 April 2007) outlines the recordkeeping requirements of the company. The policy is well out-of-date, referring to: the maintenance of electronic and paper files, and legislated requirements for recordkeeping that no longer apply or have been superseded⁶⁵;

⁶² As of August 2016, HP TRIM version 7.23 is no longer fully supported by Hewlett Packard Enterprise.

⁶³ *Inland Rail Procurement Management Plan* (01-9000-PC-POO-PL-0005) Rev 2, 7 July 2016 refers to: the use of the W network drive as the repository of all procurement documents, with specific documents (Contract Start-up and Approval to Release) to be filed in HP TRIM; and arrangements for the security of paper files. This is somewhat different to the *Inland Rail Contract Administration Plan* (01-9000-PC-PL-0021-Rev 0.4) November 2016, which refers to the use of the W network drive as the repository of all contract administration documents (until the document management system Aconex is integrated into Inland Rail), with specific documents (Approval to Amend and Variation Order) filed in HP TRIM, and arrangements for the security of paper files.

⁶⁴ Aconex, a drawing and document management system, was evaluated as a drawing management system, and implemented in the ARTC in November 2016 as the corporate-wide drawing management system.

⁶⁵ As a Commonwealth-controlled company the ARTC is not declared exempt by the Archives Regulations, and is required to comply with record-keeping obligations under the *Archives Act 1983*. The ARTC Corporate Records Management Policy: refers to the Act, but had not been updated to incorporate 16 legislative amendments since 2007; and does not refer to the *Australian Government Digital Transition Policy*, which applies to all Commonwealth agencies, including Commonwealth companies. Refer: <<http://www.naa.gov.au/information-management/digital-transition-and-digital-continuity/digital-transition-policy/index.aspx>> [accessed 11 July 2017].

- *ARTC Document Numbering* (corporate procedure COR-PR-001, issued October 2014 and updated 5 August 2015): describes the document numbering scheme for all controlled documents⁶⁶ as described in the ARTC's hierarchy of controlled documents (Appendix 7); includes that it 'applies to all of the ARTC's functions, with the exception of Engineering, which has a separate procedure'; and instructs that, in alignment with the records management policy, the Owner of a controlled document is responsible for its capture, retention and ongoing management as a record within corporate record keeping systems⁶⁷; and
- *Inland Rail Documentation Numbering Standard* (0-9000-PGV-00-SD_0001), undated, with the ARTC advising (31 May 2017) that the standard came into force during the previous 12 months. It is a one page document that identifies numbering standards for the: phases of the project; geographical locations of sections of work; disciplines (for example, environment, tunnel, rail); and document type.

3.11 There are inconsistencies in the ARTC's corporate guidance as to the numbering of documents, and the systems that should be used to manage and store documents, with the key policy well out-of-date, and arrangements for document management for the Inland Rail programme still being developed.

ARTC review of its Electronic Content Management program

3.12 Current ARTC policy is to use HP TRIM as the centralised repository for record capture and retention, notwithstanding that Inland Rail has deployed Aconex (as outlined in paragraph 3.9). In July 2017, the ARTC advised that it also utilises a number of additional platforms for document and content management practices, with some records being retained in 'shared/local drives, external hard drives, alternate third-party platforms/networks etc. [and] over the past few years, increasing demand for these platforms across the business have led to ad-hoc deployments to meet multiple content management and business efficiency requirements'.

3.13 The ARTC further advised that a review of the company's Electronic Content Management arrangements is underway and due for completion in 2020. However, this timeline is well beyond activities currently underway by the Inland Rail team to deploy Aconex as the programme's document management system, and may not resolve the issue of multiple systems and double handling of records in the company more broadly.

⁶⁶ The definition provided of a 'controlled document' is 'a reference document which, through the course of its lifecycle may be reviewed, modified and distributed several times' (paragraph 1.6).

⁶⁷ The document numbering procedure refers to HP TRIM as ARTC's Electronic Documents and Records Management System. The ARTC later contradicted the information in the numbering procedure, advising (7 June 2017) that it does not apply ARTC wide (with the exception of engineering), 'the numbering procedure relates to documents that are either part of the Safety Management System (which also includes Engineering Documents which have a different numbering system) or are Corporate procedures'.

Recommendation no.2

3.14 To improve records management, the Australian Rail Track Corporation:

- (a) revisits the scope and timeline of the Electronic Content Management review to incorporate the Inland Rail programme; and
- (b) reviews and updates its records management policies and procedures.

Australian Rail Track Corporation response: *Agreed in principle and underway.*

3.15 *ARTC has already invested in a Drawing and Document Records Management System. The Inland Rail programme has established a Quality/Systems and Audit function and Records Management/Document control team that will be a key contributor to the review and update of ARTC's policies and procedures.*

Inland Rail procurement: systems and work flow

3.16 The ARTC advised that it has used Ci Financials, supported by the vendor Technology One, for some 20 years as its financial management system. The system's Contracts module was launched in mid-2014 to manage major works contracts in the Hunter Valley division of the ARTC, with the expectation that it would allow more automated and controlled management of contracts, including the entering and monitoring of payment schedules which make up the planned contract expenditure, including variations.

3.17 The internal audit report, *FIN2 Procurement and Contract Execution*, February 2015 found that:

Due to staff changes and subsequent change in scope and certain processes from what was originally required, the system is not meeting all requirements that had been originally envisaged. It still provides appropriate governance of the contract but does not provide the additional benefits for what the system was designed.

3.18 The Contracts module was subsequently upgraded in August 2016 for the Inland Rail programme and additional workflow was introduced (although as at July 2017, this workflow had not been adopted by the ARTC's Hunter Valley division). The system's Tenders management module was also implemented in March 2017 specifically for Inland Rail.

3.19 The additional functionality (the upgrade of the Contracts module and implementation of the Tenders management module) reduces reliance on manual procedures and provides for more efficient workflow, for example, template forms and payment schedules are now available within the modules (rather than relying on completing paper based forms). There is still reliance on paper based approvals, however, as it was decided not to use the contract approval workflow in Ci Financials for delegate approvals.⁶⁸ Inland Rail management advised that they may use this workflow configuration functionality in the near future.

⁶⁸ In the current process, once the delegate(s) physically sign the relevant paper forms the documents are scanned and attached to the contract in Ci Financials where it is then work-flowed to an Inland Rail Approval Contracts Pool for electronic approval. Inland Rail management advised that although it may appear like double handling to have the paper based approval and system based approval they view it as an additional control.

3.20 As at June 2017, the Procurement and Contract Administration (Ci Financials) User Manuals have been drafted to reflect the upgraded and new modules but have not been approved. The contracts register (discussed below) is maintained in an excel workbook. The functionality exists to generate it automatically from Ci Financials but testing has not been finalised.

Did the ARTC have appropriate policies and procedures to support procurement for the pre-construction phase of the Inland Rail programme?

The ARTC did not have appropriate policies and procedures to support procurement for the pre-construction phase of the Inland Rail programme. Established procurement policies and procedures were not sufficiently robust for the administration of the Inland Rail programme. The Inland Rail team is subsequently developing a suite of procurement policies and procedures specifically for the programme, although many were still in draft form as at July 2017. If finalised and fully implemented, these documents should support a level of rigour in the programme's procurement practices not previously evidenced, and could also be applied more broadly across the company.

Procurement policies and procedures

3.21 The *Inland Rail Procurement Management Plan* September 2016, includes that 'the procurement of goods and services for the Inland Rail Programme will be conducted in accordance with relevant ARTC procedures', listing five ARTC documents.

... designed to provide the IR Programme with a structured approach to planning and implementing tendering and associated processes. These policies and procedures will provide industry with an understanding of the processes undertaken by the Programme which will ensure fairness and probity in tendering.

3.22 The documents listed in the plan are the ARTC's:

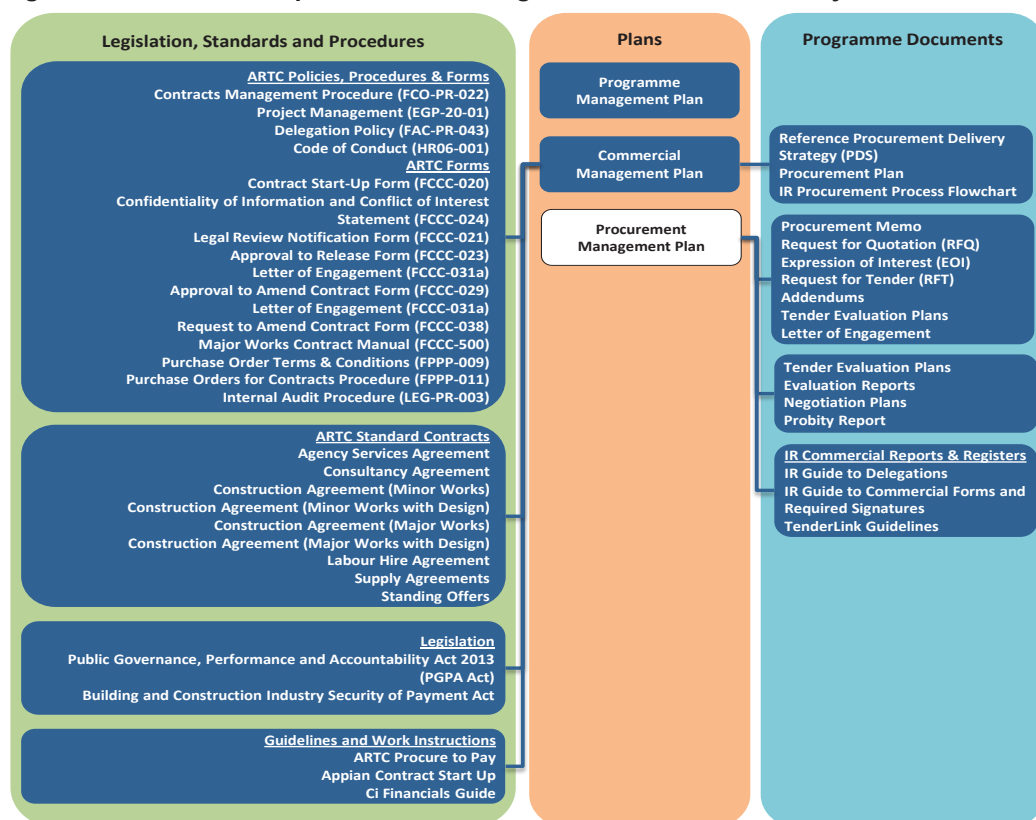
- *Contracts Management Procedure* (FCCC-001 and later FCO-PR-022), first developed in 2008 and revised, amended and updated five times between 2008 and January 2016.
 - This procedure outlines, at a high level, what is expected by ARTC personnel responsible for procurement and contract management.
- *Project Management* (EGP-20-01), first developed in 2013 and revised, amended and updated four times, with the current version dated December 2016.
 - This procedure outlines the expectations of those involved in ARTC project management at each stage of a project, and includes the actions required for the initiation, development, implementation and closure of a project.⁶⁹

⁶⁹ There were other work instructions relating to managing simple projects and complex projects that personnel could use where required.

- *Delegation Policy and Procedure* (FACA-05 and later FAC-PR-043), created February 2015.
 - This procedure outlines the authority to give financial, property and project delegation of authority, required documentation, method of recording a positions delegation and the annual review process.
- *Code of Conduct* (PEO-PO-001 and later HR06-001), January 2016.
 - This procedure outlines the principles of conduct and behaviour required of ARTC employees, directors, contractors and consultants.
- *Internal Audit Procedure* (LEG-PR-003), created November 2015.
 - This procedure outlines the requirements and responsibilities for the ARTC Audit Committee and the types or reasons for different types of audits.

3.23 The Inland Rail team has subsequently developed procurement documentation specifically for the Inland Rail programme. The procurement management document hierarchy for the Inland Rail programme, provided on 2 August 2017, is outlined in Figure 3.2. (The relationship of the plans shown in Figure 3.2 to the overall planning documents for the Inland Rail programme is at Appendix 8).

Figure 3.2: Inland Rail procurement management document hierarchy



Note: Green Section: ARTC wide documents; orange and blue sections: Inland Rail specific plans and procedural documents.

Source: ARTC, 2 August 2017.

3.24 On 22 May 2017, the ARTC advised that:

The journey of the development of the Inland Rail programme, and ARTC's role in this, has seen many changes and alterations over the period from December 2013 through to today. [and]

Throughout this period ARTC has leveraged the established, tried and tested systems and practises from within the existing business, including those used for procurement, contract and project management. As the role of ARTC changed there was a recognition that the established systems and practises needed to be adapted to better fit the specific need of the Inland Rail programme.

3.25 Documentation specific to the Inland Rail programme (blue section) provides additional prescription and guidance for procurement, for example the: *Inland Rail Procurement Management Plan* (draft 7 July 2016, finalised 30 September 2016) sets out the requirements and obligations for conducting a procurement; and *Procurement Flow Chart* July 2016, provides step-by-step instructions.

3.26 Throughout the course of this audit, many of the new procurement management documents were in draft form. When finalised and procedures fully implemented (together with full functionality of the new contract and tenders modules in CI Financials), these documents will help to strengthen the ongoing management of procurement and contracting activity for the Inland Rail programme, and may have broader application for procurement and contract management practices across the company.

Commonwealth Procurement Rules

3.27 As a Government Business Enterprise⁷⁰, the ARTC is not required to comply with the Commonwealth Procurement Rules⁷¹, although the *Inland Rail Procurement Management Plan* (01-9000-PC-PL-0005) Revision 3.0 Sep 2016, p. 6, includes the Commonwealth Procurement Rules under applicable legislation, and an earlier version of the Inland Rail procurement management documentation hierarchy (refer Figure 3.2) included reference to the Commonwealth Procurement Rules.

3.28 The ARTC advised in August 2017 that reference to the Commonwealth Procurement Rules has specifically been removed from the Inland Rail procurement management documentation hierarchy, in recognition that the legislation does not apply to the ARTC. The company emphasised that it will give due consideration to principles underpinning Commonwealth procurement in the conduct of procurement and contract management activities for the Inland Rail programme.

⁷⁰ *Public Governance and Accountability (PGPA) Act* 2013 rule 105B includes that 'The Finance Minister may, by written instrument, make provision about procurement by:... (c) wholly-owned Commonwealth companies prescribed by the rules.' As at August 2017, no such ruling has been made against the ARTC. Available from: <<http://www.finance.gov.au/resource-management/pgpa-act/>> [accessed 7 July 2017].

⁷¹ Financial framework and Commonwealth Procurement Rules issued by the Finance Minister. Available from: <<https://www.finance.gov.au/procurement/procurement-policy-and-guidance/commonwealth-procurement-rules/>>. [accessed 7 July 2017].

ARTC procurement activities for the full construction of the Inland Rail

3.29 The results of ANAO testing of a sample of 54 procurements for the Inland Rail (discussed below) concluded that the ARTC could improve its procurement practices, including to give greater consideration to obtaining value for money. The ARTC advised that it faced particular issues in the early phases of the programme that adversely impacted its procurement practices:

- urgent time constraints imposed by the Inland Rail Implementation Group reporting requirements to Government;
- significant changes in the ARTC's scope of work as the Inland Rail Implementation Group process proceeded; and
- restrictions (specifically at the PPR 3 stage) on the continuity of funding posed difficulties in framing scopes of work to be completed by specific cut-off dates and time constraints in the procurement of suppliers.

3.30 While the ARTC advised that these matters complicated procurement activities for the pre-construction phase of the Inland Rail programme, several issues identified in the ANAO testing of a sample of procurements had been previously raised in the company's internal audits (Appendix 3). These issues included: work being undertaken prior to contract execution (AM14 March 2015); procurement and tendering documents not available (FIN2 May 2015); and insufficient written justification for single source procurements (FIN01 March 2017).

3.31 The ARTC has recognised that it needs to improve its procurement activities to meet the needs of the Inland Rail programme, and (as previously discussed) work is underway to upgrade the company's systems, and policies and procedures supporting procurement, and to improve its records management. The Australian Government has committed some \$10 billion to complete the Inland Rail, and ensuring transparency and achieving value for money in contracting arrangements should be foremost in the ARTC's approach to managing the programme.

Recommendation no.3

3.32 To support transparency and value for money in contracting arrangements for the construction of the Inland Rail, the Australian Rail Track Corporation:

- (a) develops and implements policies and procedures that have suitable regard to Commonwealth procurement and contract management standards, recognising that the company is not bound by the Commonwealth Procurement Rules;
- (b) implements full functionality and controls available in procurement and contract management systems modules; and
- (c) monitors performance in procurement and contract management through increased internal audit activity and / or the implementation of a quality assurance process.

Australian Rail Track Corporation response: *Agreed in principle with qualification.*

3.33 *As previously identified, given funding, timing and ultimate delivery responsibility uncertainties in the earlier period of the programme, ARTC's early contracting/procurement methodology was suitably focussed on achieving value for money. As the programme has developed ARTC has instigated a review and update of policies and procedures for procurement and contract management, which has suitable regard to the principles of the Commonwealth Procurement Rules (as you note, we are not bound by these rules).*

3.34 *ARTC is also continuing to review its procurement framework, procurement systems controls and functionality and enhancements to CI Financials Technology One functionality.*

3.35 *ARTC will introduce a further independent review mechanism for these contracts as part of our contract management procedures in conjunction with ARTC's internal audit program. Monthly management reporting will be enhanced to include a section on procurement and contract management.*

Did the ARTC's procurement activities for the pre-construction phase of the Inland Rail programme provide value for money, including by considering competition in selection processes?

Testing of a sample of procurements undertaken between 29 April 2014 and October 2016 for the pre-construction phase of the Inland Rail programme found shortcomings in providing value for money. There could have been greater consideration of competition in the selection processes, although the use of non-competitive procurement methods was concentrated in those procurements undertaken prior to July 2015. In the sampled procurements conducted after that date, there were improvements in the levels of competitive procurements and documentation. Evidence of the importance of probity in procurement is shown through ARTC's contracting procedure, but testing identified insufficient documentation of the reasons for or against using a probity advisor. The testing also showed many variations to contract values that were not sufficiently explained, and work commencing prior to contract execution. These issues had been identified in ARTC internal audits. A review of the documentation for four later procurements showed improvement in the procurement process, consistent with the upgrade in the systems and newly developed policies and procedures supporting procurement for the Inland Rail programme.

3.36 On 19 October 2016, the ANAO selected a sample⁷² of 54 procurements from the Inland Rail programme's contract register (from a total of 231 contracts listed at that date). Of the 54 procurements in the sample, the earliest contract commenced on 29 April 2014 and the most recent commenced on 14 September 2016. At sampling date, 31 of the 54 contracts had been finalised. The total value of the 54 sampled procurements at sampling was approximately \$48.4 million, largely for consultancy services. The procurement method used for the contracts sampled, and values on commencement, is at Table 3.1.

Table 3.1: Types of procurement for Inland Rail pre-construction contracts examined

Method	Number in Sample	Commencement (Contract Value)		
		Lowest value	Highest value	Average value
Tender	26	\$80 000	\$4 739 658	\$672 425
Simple Quotes	8	\$50 000	\$840 000	\$262 570
Single Source	9	\$30 000	\$696 937	\$249 533
Standing Offers	11	NA	NA	NA

Note: Explanation of the types of procurement is provided at paragraphs 3.52–3.59.

Source: ANAO analysis from ARTC procurement data.

3.37 As previously discussed, weaknesses in the ARTC's documents and records management resulted in Inland Rail staff having difficulty in locating many of the documents for the sample of procurements, with the ANAO requesting documentation on seven different occasions between November 2016 and May 2017. The results of the testing (discussed below) are based on the documentation that the ARTC provided.

ANAO testing of a sample of ARTC procurements for Inland Rail

3.38 The ANAO tested the 54 sampled procurements against selected guidance in the *ARTC Contracts Management Procedure* FCO-PR-022 (Table 3.2).

⁷² The ANAO used Monetary Unit Sampling, a value-weighted sample selection method, where each dollar is a sampling unit. The ANAO took 71 sample intervals of \$1 million resulting in 54 contracts, as some contracts valued over \$1 000 000 would have been picked up twice. This gives the ANAO a confidence interval of approximately 97 percent that the sample is an accurate representation of the total population. The sample contracts range in value from \$87 500 to \$4 739 658.

Table 3.2: Guidance in the ARTC Contracts Management Procedure

Section	Guidance
2. Procurement Strategies	
2.1	Value for money
2.2	Probity and Ethical Behaviour
2.6	Contracts and Forms Approvals - Start-up Forms
3. Procedure	
3.2	Complete documentation of scope
3.3	Obtain offer: single source; simple quote; standing offer; formal tender
3.5	Formal Tender Process
3.9	Works should not start prior to contract execution
3.10.2	Variations

Source: ARTC Contract Management Procedure FCO-PR-022 (version 2.0 6 Jan 2016).

3.39 For all but two of the 54 sampled procurements, the *ARTC Contracts Management Procedure* FCO-PR-022 was the key procedural document for procurement in use at the time. The other two procurements were required to follow the new procedures developed for the Inland Rail programme, and there is evidence in these procurements of improved transparency and the standard of documentation available. The ARTC provided the ANAO with a complete set of documents for these procurements as the process occurred, and they contained a level of reporting that was not apparent in earlier procurement activities, such as sign off documentation for each step of the procurement process.

3.40 Further, of the 54 procurements sampled there is evidence of increased use of competitive tendering over time. Nine of 23 procurements conducted prior to July 2015 were single sourced; with no single sourced procurements for the remaining 31 procurements conducted after that date (although five of the single sourced procurements were varied after July 2015). Further, (in addition to the 54 sampled) the ANAO reviewed two procurement processes issued to the market in September 2016 (conducted under the Inland Rail programme procurement procedures, and underway during the progression of the audit), found a complete set of documentation for these procurements and compliance with the requirements of the internal procurement guidance.

Value for money

3.41 Value for money is referenced 12 times in the *ARTC Contracts Management Procedure*, including that: 'value for money is a key principle which must be reviewed before committing to a contractual outcome'; and 'effective competition underpins value for money'. Many of the contracts reviewed referenced value for money, but with limited evidence as to how it was assessed. Of note, in:

- 16 procurements, there was consideration of price as an evaluation criteria (with the weighting given to this criteria ranging from five to 40 per cent);

- 15 procurements, documentation included that the evaluation team would determine value for money for ARTC (for 13 of these procurements price was a criteria for the evaluation team); and
- six procurements, documentation included that an open procurement would not have led to greater value for money being achieved, but there is no supporting reason for this.

3.42 On 22 May 2017, the ARTC provided an explanation of its application of value for money considerations in relation to the company's procurement and contract variations decisions (Box 1, contract variations are discussed later in this chapter).

Box 1: ARTC explanation of the application of value for money

Many procurement and variation decisions taken by ARTC for the Inland Rail programme were made due to the circumstances that were associated with the way in which the project was being overseen and how funding approvals were provided; this is particularly relevant in the early phases of the programme. Each funding approval was provided with a fixed time period to achieve an agreed set of deliverables that were in many cases subsequently amended.

Typically, the durations available to complete the agreed milestones were such that achieving the desired outcomes was best achieved by retaining parties (individuals and companies) that either had extensive project knowledge or had developed specific project IP...Looked at as a whole and in retrospect this resulted in significant increase to the values of each of these contracts but when considered at each decision point the extent of the change was in line with the requirement at the time.

These circumstances were widely known within the project oversight group, ARTC and the Inland Rail programme team and when procurement and variation decisions were being taken these circumstances were considered when assessing a best value for money approach. Many such assessments were made through verbal discussions and face-to-face meetings rather than by extensive written reports due to those circumstances.

The circumstances were also such that in some instances it was deemed that the best value for money approach was to retain an existing service provider (having already been subject to a competitive process for initial selection^a), as there was not adequate time to re-tender the services and for that potential new service provider to be able to develop the project knowledge in time to meet the deliverable. Also, that in some circumstances the value of the variation and the duration of the contract was such that it was deemed highly unlikely to, or would not to create appropriate competition in the market to warrant a new round of market engagement. These contracts were made under previously competitive tendered rates and these rates have remained the same or in some cases, reductions have been negotiated in light of the increased scope.

In summary, ARTC determined that procurement and variation decisions were made with a view to achieving a value for money outcome and meeting project requirements in the circumstances at the time.

Note a: However, as shown in Table 3.5, the two largest percentage variations in the contracts tested were from single source procurement processes.

3.43 The explanations provided by the ARTC were not evident in the documentation examined for the sampled procurements, and no records or notes were provided of the assessments that were ‘made through verbal discussions and face-to-face meetings’.

Probity and ethical behaviour

3.44 The ARTC *Contracts Management Procedure* states that ‘general probity principles should be applied in all interactions with external parties’, referring to: an ‘independent person’, generally from Contracts Services who will provide an independent view on commercial, probity and tendering processes; and a ‘probity advisor’, an external advisor who review and reports on the bidding and selection process of high level risk major works procurement’. The guidance did not clarify the basis for using internal or external probity advice, and should do so. The procedure also includes that the key principles that should be considered are: to use appropriately competitive process; fairness and impartiality; consistency and transparency of process; and conflicts of interest.

3.45 On 22 May 2017, the ARTC advised that:

The principle used by the Inland Rail procurement team on the use of probity advisors during a tender process is that an independent probity advisor will be used on all open tenders and any other tender that is deemed to have a probity risk, i.e. is of high value, is complex or involves a significant number of incumbent service providers. Where an independent probity advisor is not used then probity [is] managed by a representative from the Inland Rail procurement team. The probity advisor provides support and oversight on these packages.

3.46 An initial probity advisor was engaged in 2014, and commenced developing a draft Inland Rail specific probity plan. The plan was not formally approved until March 2017⁷³, under a newly engaged Inland Rail programme-wide probity advisor.

3.47 The procedure notes (p. 21) ‘on large value or complex tenders the ARTC Executive or the General Manager Procurement and Contracts may request a Probity Advisor is engaged for the project’. The ANAO has identified a probity advisor for 15 of the 26 tendered procurements in the sample tested:

- for six of the 15 tenders, a representative from the Probity Contractor procured by ARTC in 2014 acted as the probity advisor (three of six of these tenders were open market and the remaining three were select tenders); and
- of the remaining nine tenders, two Inland Rail staff members acted as the Probity Advisor (one staff member for eight tenders that were select tenders; and another for one tender that was the open market tender for Probity Services);
- for one open market tender in the sample, no probity advisor could be identified;
- for 16 procurements, due to a lack of documentation, it cannot be determined whether a probity advisor would have been appropriate.

⁷³ A draft Inland Rail Probity Management Plan was first developed in November 2014 and was amended and revised 15 times prior to ARTC approving the document on 17 March 2017; more than two years after the initial draft was reviewed.

3.48 The ARTC guidance recognises the importance of probity and the existence of a probity advisor to the procurement process. However, there was not sufficient documentation to confirm that this guidance had been followed on the pre-construction phase of the Inland Rail programme.

Contract approval and planning

Contract Start-up Forms

3.49 The ARTC *Contracts Management Procedure* refers throughout to the Start-up Form—a key document in the procurement process, requiring: information on the method of procurement; scope of works; estimated cost of the procurement (based on the required scope of works and deliverables); and in the case of single source, confirmation that no conflict of interests exist for the procurement for approval by delegated positions. The procedure includes that ‘Authorisation of the Start-up Form provides evidence that the signatory accepts the estimated cost for the scope of work to be let, and approves single sourcing or restricted tenders if applicable’.

3.50 Start-up Forms were available for all of the 54 procurements sampled, and provided an estimate of the cost of the procurement. The ANAO compared the estimates in the Start-up Forms with the actual value of the procurements at contract execution, (with the exception of 11 standing offers that are valued on the Letters of Engagements resulting from the contract, rather than a set cost for pre-determined works). Of the 43 procurements: in eight, the estimates in the Start-up Forms and the actual value of the procurements at execution matched exactly; six were within five per cent of the estimates; and 29 were greater than five per cent (ranging from -\$2 703 874 to + \$998 653) including two where the values at execution of the contracts differed from the estimates in the Start-up Form by more than 100 per cent (Table 3.3).

Table 3.3: Variance in contract estimates for Inland Rail pre-construction contracts

Percentage difference (%)	Number estimated under contract value	Number estimated over contract value
5–20	7	1
21–60	7	3
61–100	7	2
100+	0	2
Total	21	8

Source: ANAO analysis of 29 procurements with budget estimates in excess of a five per cent margin.

3.51 In response, the ARTC advised that in:

- 12 procurements, the estimate was completed prior to finalisation of scope;
- six procurements, the rates or length of the procurement used for the estimate were different from that in the tenders;
- four procurements, there were restrictions on contracting (as previously referred);
- four procurements, the estimate was based on procuring multiple contracts for the same service. The sampled contracts do not represent all contracts resulting from the start-up forms; and
- three procurements, it cannot fully explain the estimate.

3.52 The number of procurement estimates that vary from the cost of the procurement at contract execution indicates room for improvement in the company's estimation process, including to support greater accuracy in budget estimates.

Complete documentation of scope

3.53 The procedure includes (section 3.2) that 'The Project Manager is responsible for completing the documentation which describes the required service, any budget information ..., and any drawings and technical specifications necessary to ensure the Contractor is fully informed of the contract expectations.' A scope of the procurement was available for 36 of the 43 procurements sampled: eight of nine Single Source procurements, six of eight simple quotes procurements and 22 of 26 tenders (11 standing offers are not included as they do not require a scope).

Obtaining offers (type of procurement)

3.54 The procedure states that: 'in selecting how to obtain an offer consideration must be taken of the project risks and scale against the overriding objectives of: safety; ethics and probity; market competition; reliability, quality and efficiency of the contractor; and effective use of ARTC resources'. The procedure describes four processes for obtaining an offer; single source, simple quotes, standing offers and formal tender.

Single source

3.55 Single source: 'can only be used when it is the only practical and economic option ... the invitation to quote, receiving the quote and subsequent evaluation is all managed by the Project Manager ... the Project Manager must justify the single source option in the contract start-up form and support this with sufficient evidence'.

3.56 The use of single source as a procurement method changed for the 54 procurements sampled. Twenty-two of the sampled procurements were executed prior to July 2015, of which nine were single source, the highest cost being almost \$700 000 on start-up (Table 3.1). Of the remaining 31 procurement in the sample that were entered into after June 2015, none were single source.

3.57 The contract start up form has a check box providing reasoning for single source procurements. In one procurement, the ARTC selected that time constraints prevented alternate sourcing. In six procurements the ARTC selected 'Other' reasoning; this was for the continuation of services, or to directly contract a sub-contractor. In two procurements both options were selected for the continuation of services and requirements to meet Milestone Packages.

Simple quotes

3.58 Simple quotes: 'only to be used when the scope is simple, low risk and within a project manager's delegation and there are potential suppliers of equal quality and proven experience in work with ARTC. In addition, evaluation for simple quotes is not required, but 'may be done in consultation with the Contracts Service Administrator at the discretion of the Project Manager'.

3.59 The ANAO has not been able to determine if the criteria of low risk and simple scope have been met based on the documentation provided by the ARTC.

Standing offer

3.60 Documentation provided by the ARTC states: Standing offers are ‘to be used where the contractor is regularly required for similar works...these works are for a maximum of 12 months and work is to commence after a letter of engagement is executed’. It is advised that Standing Offers should not be used on a month to month basis to avoid delegation procedures. ANAO analysis of the standing offers within the ANAO sample showed the ARTC following the direction set out within its internal Procurement documentation.

Formal tender

3.61 Formal tender: procuring by formal tender is the preferable option, ‘to ensure value for money is being obtained and the market is sufficiently tested ... unless appropriate justification is available to single source, obtain simple quotes, or utilise a standing offer’; The documentation does not provide any guidance as to how appropriate justification would be defined.

3.62 ARTC has provided some explanations as to why the Inland Rail team elected to use non-competitive or less competitive procurement processes. In nine of 54 procurements the ARTC response was that the contract procurement and execution was ‘pre-current team’, either Inland Rail broadly or Commercial Team specifically.

Tender process

Time given to tender

3.63 The Commonwealth Procurement Rules state:

The time limit for *potential suppliers* to lodge a *submission* **must** be at least 25 days from the date and time that a *relevant entity* publishes an *approach to market* for an *open tender* or a *prequalified tender*, except under the following circumstances when a *relevant entity* may establish a time limit that is less than 25 days but no less than 10 days.⁷⁴

3.64 As previously discussed, the ARTC is not required to comply with the Commonwealth Procurement Rules, but there is no guidance provided in the ARTC (including Inland Rail) documentation reviewed for this audit, as to how many days should be allowed for potential suppliers to lodge a submission to an approach to market, including for different types of tender, open or select tender. Analysis of the 26 tenders in the sample is provided in Table 3.4.

⁷⁴ Commonwealth Procurement Rules July 2014 page 30 paragraph 10.19.

Available from: <<https://www.finance.gov.au/sites/default/files/2014-commonwealth-procurement-rules.pdf>>, [accessed 10 July 2017].

Table 3.4: Time tenders were open for submissions

Duration of tender period	Number of tenders	Average value (at commencement)
1–5 days	3	\$166 667
6–10 days	5	\$180 953
11–15 days	3	\$408 497
16+ days	14	\$1 029 769
Unable to determine duration	1	\$436 040
Total/average	26	\$672 425

Source: ANAO analysis of ARTC documentation.

3.65 Ten of the 26 tenders were open for less time than the absolute minimum (10 days) stated in the Commonwealth Procurement Rules as best practice. In two of the procurements, there was insufficient documentation to assess the timeframe.

Tender evaluation documentation

3.66 The procedure refers throughout to the evaluation process for tenders, including the development of evaluation plans and reports that include weightings for the criteria according to their relative importance or priority. For the 26 tenders in the sample, complete documentation (that is, a request for tender, evaluation plan and evaluation report) was provided for 17 procurements. Where the three documents were provided, there was no consistency between the evaluation criteria included in each of them. Examples of inconsistencies in criteria included:

- in one procurement, assessment of the tenders included (with a twenty five per cent weighting) that the ‘proposed methodology in providing the Services demonstrates the Tenderer’s capability and experience in the planning, management and delivery of the Services and that the Tenderer’s proposed management structure and methodology will integrate with the management and delivery of the Project as a whole’. This criteria was not listed in the Request for Tender documents; and
- in another procurement, the assessment of the tenders included (with a five per cent weighting) their ‘approach to regional participation.’ This criteria was not included in the Request for Tender documents.

Works commenced before contract execution

3.67 The procedure includes that ‘works must not commence prior to the contract being executed unless there are exceptional circumstances’. In 22⁷⁵ of the procurements of 54 in the sample, work commenced prior to contract execution.⁷⁶ The ARTC agreed that work had commenced prior to contract execution in 14 procurements, and advised that with regard to eight procurements, in:

⁷⁵ Three instances of contracts commencing prior to contract execution within the ANAO sample were also identified in the ARTC Internal audit of Inland Rail.

⁷⁶ The ANAO reviewed contract execution dates, invoices and surrounding evidence provided by the ARTC during evidence collection.

- four procurements the invoice contained inaccuracies;
- one procurement, a Letter of Intent, works were allowed to commence early;
- one procurement there was no date on the invoice and so early commencement cannot be determined;
- one procurement works did not start prior to contract execution, as there is an early start letter on file, which would provide approval to commence work prior to contract execution (but no evidence was provided); and
- one procurement the ARTC did not respond to the ANAO request for information.

3.68 As previously referred, works commencing prior to contract execution has been raised in two internal audit reports: one in late 2012, resulting in a memo to all staff involved in procurements or contracts, highlighting the risks to the company where this occurs ; and more recently (March 2015) in an internal audit of the Inland Rail Programme Governance Framework (Appendix 3). This issue has clearly not been addressed, with the ARTC advising in August 2017 that it will be the subject of ongoing focus.

Variations

3.69 The procedure states that, 'in some cases, it is often more prudent to raise a new contract than raise a Variation', providing three instances where project managers should not continue to vary a contract: where the original contract has been completed and closed out; where there have been safety or legislative changes from the original contract; and changes to the scope of the original contract.

3.70 Across 43 (tenders, simple quotes and single source procurements) of the 54 procurements sampled, there were a total 145 variations, with the three greatest variations shown in Table 3.5.

Table 3.5: Three greatest variations in the sample of Inland Rail pre-construction programme procurements

Contract number	Value of contract at execution	Number of variations	Contract value (as at October 2016)	Percentage increase from execution to October 2016 (%)
NSW-TC-04040 Simple quote	\$50 000	5	\$411 000	722
CA-NSW-04211 Single source	\$180 000	7	\$1 901 142	956
SC-NSW-03872 Single source	\$60 000	3	\$1 640 000	2633

Source: ANAO analysis of ARTC documentation.

3.71 In order to vary a contract the Contract Manager must send a Request to Amend Contract Form (FCO-FM-027) to the Contract Services Administrator. In this regard, for:

- one simple quote procurement, a variation was made after the contract had expired;
- eight of the nine single source procurements, there was completed variation documentation;
- a single source procurement, a fourth variation was started which later became a new single source procurement; and
- the remaining single source procurement, no documentation was provided for the four variations made to this contract.



Grant Hehir
Auditor-General

Canberra ACT
27 September 2017

Appendices

Appendix 1 Entity responses



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12 September 2017

Mr Grant Hehir
Auditor General
Australian National Audit Office

Via email – Officeoftheauditorgeneralperformanceaudit@anao.gov.au

Dear Mr Hehir

Thank you for the opportunity to respond to the Australian National Audit Office's (ANAO) report on the pre-construction phase of the Inland Rail Programme.

ARTC acknowledges the positive findings in relation to governance and appropriate management of grant funding.

ARTC is committed to continuous improvement and takes audit recommendations very seriously. Indeed, as recognised in the body of your report, steps have already been initiated to address the improvement opportunities.

Notwithstanding this, we are concerned that the report does not adequately reflect the context within which decisions were made. More specifically, we make the following observations:

1. ARTC was only confirmed as the delivery agency for Inland Rail in May 2016, and the funding commitment to the programme was only made in the May 2017 Budget.
2. Prior to that, significant uncertainty existed as to continuity, scope and delivery responsibilities for the programme, including:
 - ARTC's scope of work in support of the Inland Rail Implementation Group (IRIG) changed as the process proceeded, with it still being subject to approval by Infrastructure Australia.
 - Restrictions existed on the continuity of funding, imposing constraints on ARTC's ability to procure the programme in a long-term manner.
 - ARTC's request for a structured two year programme in relation to Project Proposal Report (PPR) 3 was only partially approved, with a time constraint of July 2016 being imposed on the letting of contracts.

These uncertainties and constraints limited ARTC's ability to frame its normal scope of works, imposed constraints on the procurement of suppliers and prevented ARTC from fully incorporating Inland Rail into ARTC's corporate procurement, contract management and risk processes.

3. Most contracts were procured through tenders or from standing offers (which themselves were selected through tender processes).
 - 45 out of 54 procurements were competitively sourced through tendering, simple quotes and standing offers; and
 - 9 out of 54 procurements were single sourced, with none of those occurring after July 2015. 2 of those 9 were with suppliers who had originally been selected through open tender for the Inland Rail Alignment Study, giving them domain knowledge and therefore well placed to meet the tight timeframes.

Page 1 of 2

Australian Rail Track Corporation Ltd

ACN 081 455 754

ABN 75 081 455 754

ARTC

- Early stage single sourcing directly reflected IRIG time pressures and the available knowledge at that time regarding the scope, which often required subsequent extension or amendment.

Suppliers and contractors were deliberately sourced to deliver "value for money", including by enabling cost effective termination in the event that the programme did not proceed and with a view to avoiding retrenchment costs should that be required.

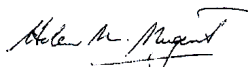
4. ARTC makes the following observations in relation to Inland Rail's property management:

- ARTC had two guiding principles in relation to its Inland Rail property strategy to meet the programme needs, namely that it should be low cost and initially of a short term nature. This reflected uncertainty in relation to the continuity of the programme.
- With these underpinning principles, the Inland Rail programme benefitted from ARTC's overall property knowledge and perspectives, with its operating from 60 locations on a national basis.
- The two offices out of which the Inland Rail programme operated reflected the known short-term headcount, suitable locations to facilitate internal and external key stakeholder engagement and represented value for money given programme uncertainty.
- ARTC will review its property approach given the May 2017 Budget announcement and the Government's longer term commitment to fund the Inland Rail programme under ARTC's auspices.

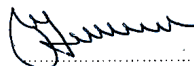
Finally as your report notes, while the Minister's required funding agreement was not concluded, ARTC developed detailed scope of works and milestone deliverables as part of submission of each project proposal report (PPR).

The recommendations of the report and ARTC's individual responses are set out in Attachment A.

Yours sincerely



.....
Helen Nugent AO
Chairman



.....
John Fullerton
Managing Director and CEO

Attachment A

Recommendation No.1

- 2.33 To improve the management of risk, the Australian Rail Track Corporation accelerates the implementation of a fit-for-purpose risk management system for the Inland Rail programme.

Entity response:

2.34 ARTC response: Agreed in principle

At the time of procurement of the new risk system, the Inland Rail programme was not confirmed as definitely proceeding and ARTC was not confirmed as the entity to deliver the programme.

Therefore specific requirements for functionality, analytic capabilities and system interoperability in relation to the management of the Inland Rail programme delivery risks were not considered. Additionally, management decisions were made to keep the Inland Rail risk register separate from the ARTC business units to readily facilitate handover to another entity, in the event ARTC was not selected to deliver the programme, as was requested by Government.

Risk continues to be managed effectively on the Inland Rail programme. However, with the programme now funded to proceed and ARTC confirmed to deliver the programme, ARTC is currently reviewing business needs for the ongoing management of the Inland Rail programme delivery risks and developing an appropriate risk management system for use going forward.

Recommendation No.2

- 3.14 To improve records management, the Australian Rail Track Corporation:

- a) revisits the scope and timeline of the Electronic Content Management review to incorporate the Inland Rail programme; and
- b) reviews and updates its records management policies and procedures.

Entity response:

3.15 ARTC response: Agreed in principle and underway

ARTC has already invested in a Drawing and Document Records Management System.-The Inland Rail programme has established a Quality/Systems & Audit function and Records Management/Document control team that will be a key contributor to the review and update of ARTC'S policies and procedures.

S e n s i t i v e



Australian Government

Department of Infrastructure and Regional Development

Secretary

PDR ID: EC17-001252

Mr Paul Bryant
 Executive Director Performance Audit
 Australian National Audit Office
 GPO Box 707
 Canberra ACT 2601

Dear Mr Bryant

**Australian National Audit Office (ANAO) - Proposed Report: Management of the
 Pre-construction Phase of the Inland Rail Programme**

Thank you for your email of 15 August 2017 providing the ANAO's Proposed Report on the
Management of the Pre-construction Phase of the Inland Rail Programme.

The Department supports the recommendations provided in the report.

I note the report considers the Department's governance of the Programme was appropriate, especially
 in relation to the uncertainty regarding the Government's interests with regard to longer term decisions
 about its delivery.

The Department will also consider the report's observations of the Department's management of
 pre-construction grant funding. The Australian Government provided additional funding to the
 Department of Infrastructure and Regional Development in the 2107 Budget for activities to support
 the development of Inland Rail, including enhancing the Department's oversight of the project noting
 the Australian Rail Track Corporation (ARTC) is responsible and accountable for project delivery.

As you are aware, the ARTC is an independent Government Business Enterprise reporting to a Board
 which reports to the Minister for Infrastructure and Transport and the Minister for Finance, as
 Shareholder Ministers. Going forward, the funding for Inland Rail from the Australian Government
 will be in the form of an equity funding relationship. The report and recommendations will help shape
 this relationship and the Department's oversight in the future.

As the report notes as part of its delivery of Inland Rail, the ARTC has already commenced action that
 will improve ARTC's procurement practices and risk management processes. I expect the ARTC
 Board will have due regard to the report and will take action for the timely completion of the report's
 recommendations. Further to this, I expect the ARTC Board will provide regular advice to the
 Shareholders Ministers confirming how and when all of the recommendations will be implemented.

Yours sincerely

Mike Mrdak AO

10 September 2017

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S e n s i t i v e



Australian Government
Department of Finance

Rosemary Huxtable PSM
Secretary

Our Ref: SEC0014788

Mr Grant Hehir
Auditor-General
Australian National Audit Office
GPO Box 707
Canberra, ACT, 2601

Dear Mr Hehir ^{Grant}

I refer to the Australian National Audit Office's (ANAO) correspondence of 15 August 2017, seeking the Department of Finance's response to the proposed ANAO Audit Report, *Management of the Pre-construction Phase of the Inland Rail Programme* (the Report).

Thank you for the opportunity to respond to the matters raised in the Report. Finance agrees with the ANAO's recommendations.

The Government announced in the 2017-18 Budget that it will invest a further \$8.4 billion in equity in the Australian Rail Track Corporation to deliver the Inland Rail project. The ANAO's findings will assist agencies and the ARTC, and will inform appropriate oversight and governance arrangements related to the delivery of the project. To this end, a Secretary-level Sponsors Group, including the Chairperson of ARTC, has been established to closely monitor progress of the project.

Yours sincerely

Rosemary Huxtable
Secretary

7 September 2017

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Appendix 2 Reporting to the ARTC Board on the pre-construction phase of the Inland Rail programme

Type of reporting	Regularity of reporting	Comments
Reports to the Board	Each board meeting	CEO's report on all but six occasions in the period to May 2017. Quarterly shareholder report is approved by the board before submitting to shareholders.
Meetings of the Board	Each board meeting	Up to the period August 2016 Inland Rail issues were dealt with as general by the Board. From August 2016 a discreet Inland Rail Board item.
Other reporting to the Board	On request	ARTC advised that eleven special reporting requests were made by the Board and responded to by the Inland Rail team in the period to May 2017.

Source: ANAO review of ARTC documentation.

Appendix 3 Internal audit reports

AM 14, Inland Rail Programme Governance Framework, March 2015

Findings and agreed actions

Work been undertaken by contractors for the Programme Team prior to having an approved contract in place

1	Ensure that all personnel on the Programme Team are trained in the complete ARTC procurement and contract administration processes.
2	Review and refine the existing ARTC procurement and contract administration processes as they apply to the Inland Rail Programme, to ensure they align with the Programme requirements, whilst managing the risk to ARTC by implementing suitable controls.
3	Define roles and responsibilities between the Programme Team and the ARTC Contract Team with a goal to provide the Programme Team more independence and control. This would need to include ensuring the Inland Rail Team has the dedicated resources assigned which will enable them to fulfil any increase in responsibility.
4	Align the procurement schedule with the overall Programme schedule to ensure as much forewarning of procurement requirements is provided.

Commitment of expenditure in the absence of agreed funding needs to be a transparent process

1	Develop a procedure regarding pre-release of ARTC funds.
2	Ensure dedicated financial support is assigned to the Programme, Project Managers update their schedule of works and forecasts on a monthly basis and systems are aligned to support the forecasting and cost management processes.

Process Improvement Opportunities

Overall governance including the use of steering committees. There are multiple steering committees currently in place to oversee the progress of the Inland Rail Programme Team. The governance structure will need to be further developed to suit a Programme of works of this scale and risk profile as it moves into the delivery phase.

Team Structure and Roles and Responsibilities. Ultimate team structure to be determined by final delivery phase governance model. Roles and responsibilities to be clarified through formal position descriptions.

Delegations of Authority. Both decision making and financial delegations of authority for the Programme should be improved to accommodate for a Programme of works of this size.

Cost Management. The Programme Team must lock in the Work Breakdown Structure (WBS) and align scope, cost, schedule, procurement and contract management systems.

Change Management. The Inland Rail Programme should implement a change management process to manage and assess the impact of all changes that affect scope, time and/or cost and track trends.

Risk and Issue Management. Risk identification has been conducted by the Programme Team and there is a good understanding of programme risks. The risk process is yet to commence active management, control, close out and monitoring of risks.

Quality Management. The Programme Team should implement a Quality Management System to ensure the Programme meets the stated needs and delivers the objectives and benefits to the Federal Government in line with ARTC requirements.

Training. Training of individuals is being conducted in ARTC induction processes. An Inland Rail Programme specific “on-boarding” training process may be useful as the Programme Team ramps up toward the next phase of work.

IM18, Systems Developed Outside of IT, February 2015	
Findings and agreed actions	
Limited awareness of the need to present business case to the ICT Committee	
1	The restructured IT department will place strong emphasis on early stakeholder engagement via a PMO to identify requests for IT business solutions before a decision is made to develop any projects, including those outside of IT.
2	Currently the newly appointed PMO is canvassing key stakeholders and developing a comprehensive map of all applications. This map will be analysed by the Enterprise Architect and high risk applications (shadow IT) will be developed, with recommendations regarding remediation strategy.
Inconsistencies in the process to manage user access to systems	
1	Capture and identify systems not complying to the CSA process.
2	The PMO and newly appointed Applications Manager will jointly develop recommendations to remove these inconsistencies.
Inconsistencies in the process to manage changes to end-user developed systems	
1	The PMO and newly appointed Applications Manager will jointly develop recommendations to remove these inconsistencies.
'Old' databases continue to be stored on file servers	
1	Data Bases will be cleansed as part of BAU duties and as time permits
Inconsistencies in the process to manage software licences	
1	The National Manager ICT Services, in conjunction with the PMO, will develop a standard procedure to rectify.
Lack of ownership and inconsistent process to maintain the Application Register	
1	The maintenance of the Application Register will become the responsibility of the Enterprise Architect with sign off validation by the PMO.
Limited awareness of relevant IT Policies	
1	IT will undertake a marketing program concurrent with the appointment of the National Manager Applications. Marketing /awareness program to be led by General Manager S&T.
Process Improvement Opportunities	
IT Procurement. ARTC should consider developing a procedure that provides guidance on how Software Support Arrangements should be recorded in Ci Financials.	
CTX Database rebuild planning may duplicate Eclipse 8 functionality. Subject to resolution of current issues with the Ellipse 8 project, ARTC should consider revalidating whether existing functionality in the ongoing asset databases that have not yet been migrated to Ellipse 8, will be available in Ellipse 8 in the short or longer term.	

FIN02, Procurement and Contract Execution, May 2015**Findings and agreed actions [redacted]****Inappropriate contract used**

1	Educate the respective contract managers on the importance of using the correct contract type including how using the incorrect contract exposes ARTC to additional risk.
2	Contract Services work with the respective contract managers to establish a standing offer contract or full contract for the following: a. Hook and pull services for the AK Car with [nominated external supplier] b. IT consulting services with [nominated external supplier].
3	Continue to raise, in purchasing and contracts training, that standard purchase orders require clear and accurate descriptions of the goods/services purchased per the "Contracts Management" procedure (FCCC-001) and similarly notify staff directly and/or via the weekly news.

Process Improvement Opportunities

Current contract template not used. For the consultancy services contract identified, if the contract is to be renewed/extended when it expires on 30 June 2015 then the current consultancy services contract template should be used.

Efficiency of contract approval process. Review the tendering and contracting approval requirements, including delegations of authority, to determine if sign-off requirements could be reduced.

Retention of contracting and tendering documents. Develop a work instruction that details what documents are to be obtained by Contract Services as evidence of the tendering and contracting process and where the documents are to be retained.

Adequacy of Contract Services file notes. Develop a work instruction which details the recording of appropriate file notes on the contract file for the procurement and contracting method and process applied.

Tender evaluation plan template for high risk and high value tenders. Develop a tender evaluation plan template to be used across the business for high value and high risk tenders. Management have informed Internal Audit that a reference will be added in the Contract Procedure at the next update.

Update Ci Financials Major Works Contracts Module. If possible, update the contract module in Ci Financials to allow calculation and production of payment claims in the system.

Finalise User Guide for Ci Financials Major Works Contracts Module. Once the module is updated the user guide should also be updated, approved as final and published on the ARTC Intranet to allow all potential users access to it.

FIN01, Procure to Pay, 21 March 2017	
Findings and agreed actions	
Formal Tenders – Lack of key control documentation during tender process	
1	Reinforce to all ARTC personnel that 'Conflict of Interest and Confidentiality of Information' forms must be signed by all tender evaluation team members prior to evaluating tenders.
2	Ensure that the two members of the tender evaluation committee who did not sign a 'Conflict of Interest and Confidentiality of Information' form make a declaration (via a file note) that they did not have any conflicts of interest with any of the tenderers and that they kept all information confidential.
3	Update the tender evaluation criteria template to include a field for the date that the evaluation criteria were agreed by the evaluation panel.
4	Review the contracts management procedure and consider updating the process for formal tender procurements to require the Contracts Services Team involvement in tenders over certain risk thresholds (e.g. over a certain value) to ensure that the tendering process is appropriate (e.g. composition of the tender evaluation committee) and well documented. Any changes to the process will require Executive Committee approval.
Requirements for when the simple quotes procurement method can be used do not appear to have been met	
1	Review the Contracts Management Procedure and consider introducing thresholds as to when the simple quotes procurement method can be used (e.g. over a certain value) or other appropriate amendments. Any changes to the process will require Executive Committee approval.
Standard purchase orders used instead of full contract	
1	For each of the four exceptions identified, review the purchase and determine if the terms and conditions in place are appropriate to protect ARTC.
2	Reinforce to all ARTC personnel when a standard purchase order can and cannot be used and that all contracts need to comply with the Contracts Management Procedure.
3	Review the Contracts Management Procedure and consider whether additional controls are required in relation to standard purchase orders or if other amendments should be made to the Procedure.
Single source procurement justification	
1	Review the Contracts Management Procedure and consider updating the process for single source procurements to strengthen requirements as to why the single source procurement method was used including if applicable, information on any incumbent and term and why single source is proposed. Any changes to the process will require Executive Committee approval.
2	Review the Contracts Management Procedure regarding when single source can or cannot be used and consider whether thresholds should be introduced regarding when single source can and cannot be used. Any changes to the process will require Executive Committee approval.
Approval to Release and Contract Start-Up forms not signed by someone with sufficient delegation of authority	
1	Update the contract checklist to confirm that the delegation of authority requirements have been met. The contract checklist is used by the Contract Services Team to check if all contract documentation is in accordance with the contracts management procedures.

Findings and agreed actions

Electronic signatures

1	Reinforce to all ARTC personnel that electronic signatures should not be used to execute contracts and when used on other documents they should be accompanied by email evidence showing that use of the electronic signature was approved by its owner.
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Plant hire

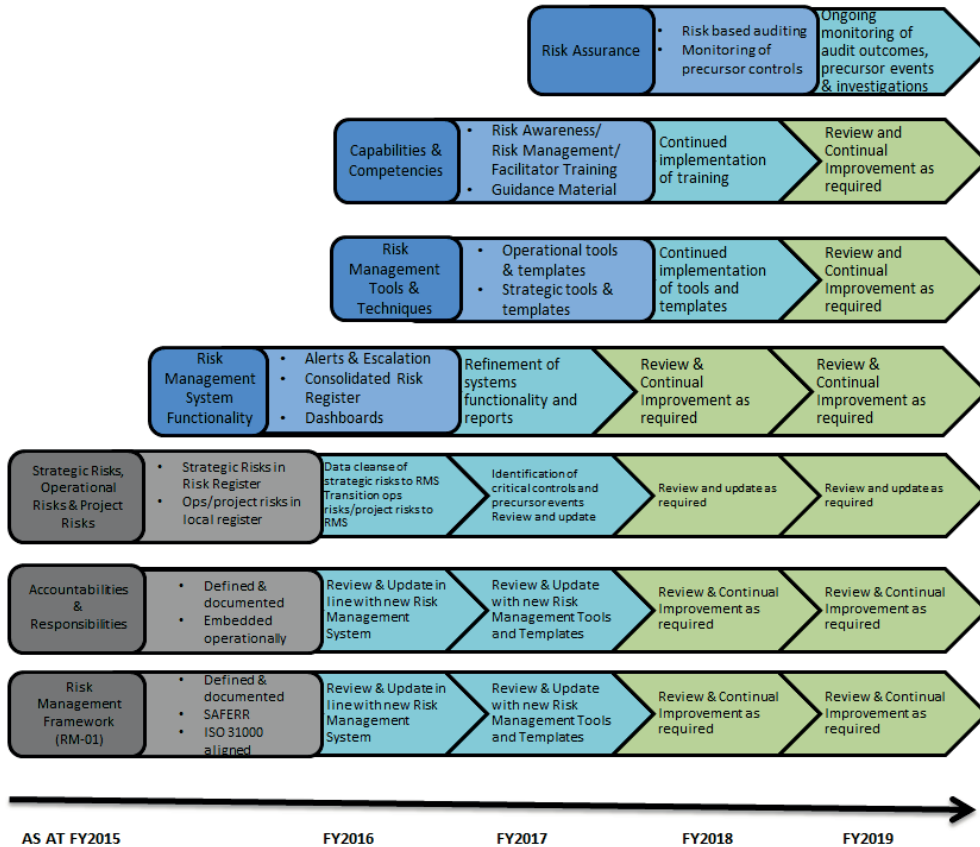
1	As part of the Continuous Improvement project activities being undertaken by the Contract Services Team the process for plant hire is being reviewed and it is expected that the process will change significantly, including removing the use of the hire of equipment contract type and reviewing maximum hire terms and financial thresholds. Management believe that these changes will address causes of the findings identified by Internal Audit.
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Process Improvement Opportunities

Appian Contract Start-Up form. The Appian Contract Start Up form be amended so that more than one vendor has to be entered into the form for full tender, simple quotes and standing offer procurements before the form can be progressed. To enforce segregation of duties the roles of "Project Manager" and "Delegation" are required to be different people in Appian. At the moment the same person can be selected for both.

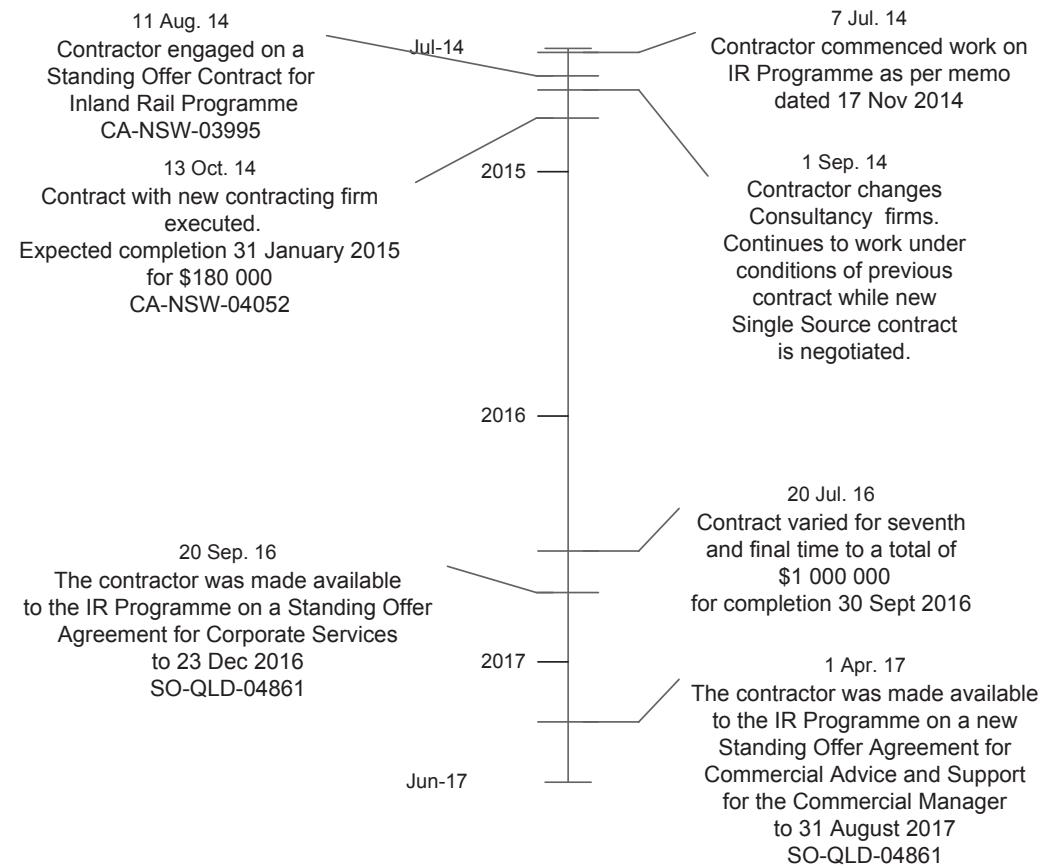
Document naming conventions for Contracts Services Team files. It was noted that some documentation showing evidence of the procurement processes and controls applied were difficult to locate on the Contract Services Team electronic file due to inappropriate naming of documentation. It is recommended that document naming conventions for the contracts files are implemented by the Contracts Services Team to make it easier to locate documentation.

Appendix 4 ARTC Risk Improvement Strategy



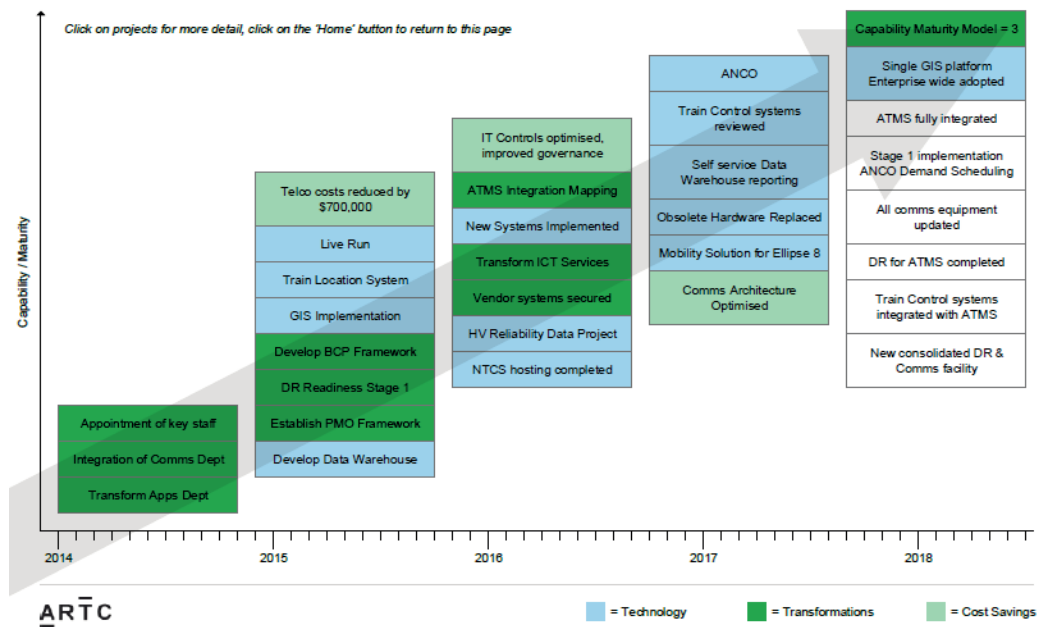
Source: ARTC Risk Management Improvement Plan.

Appendix 5 Timeline of a contractor



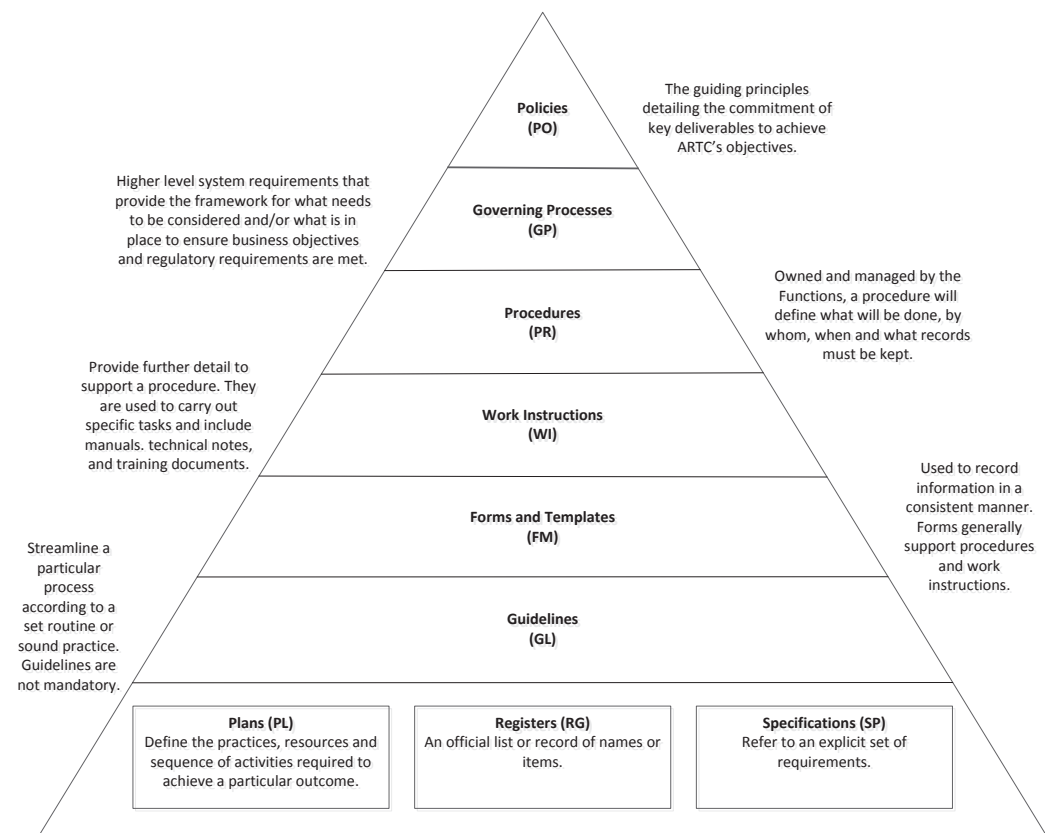
Source: ANAO, from ARTC documentation.

Appendix 6 Systems & Technology Road Map – as at October 2015



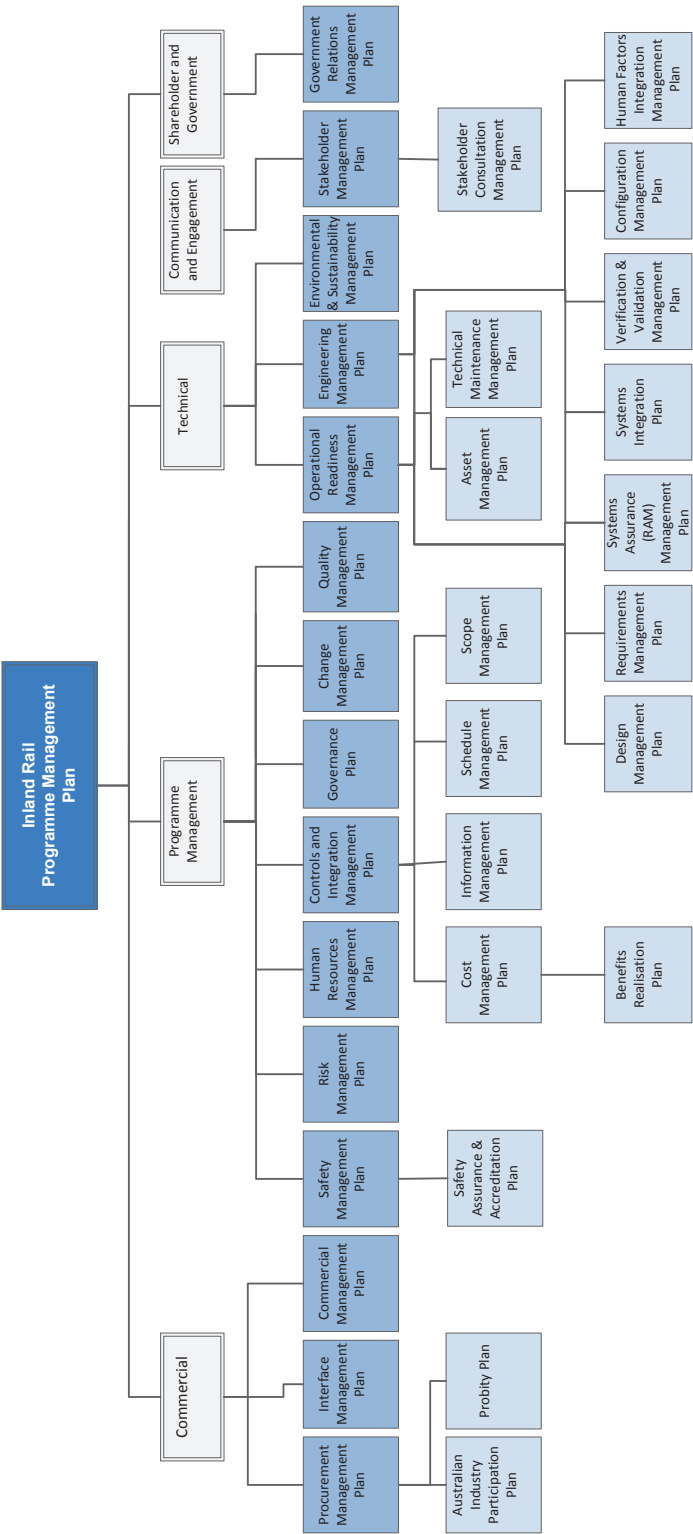
Source: ARTC Systems and Technology Road Map.

Appendix 7 ARTC: hierarchy of controlled documents



Source: ANAO, adapted from ARTC, Document Numbering COR-PR-001, 5 August 2015, pp. 5–6.

Appendix 8 Inland Rail: hierarchy of documents



Source: Inland Rail Programme Management Plan p. 2.

