

The Auditor-General

Evaluation Processes for the Selection of Hearing Devices

Department of Health and
Family Services

Australian National Audit Office

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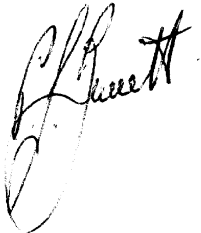
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Canberra ACT
29 June 1998

Dear Madam President
Dear Mr Speaker

The Australian National Audit Office has undertaken a performance audit of the Department of Health and Family Services in accordance with the authority contained in the *Auditor-General Act 1997*. I present this report of this audit, and the accompanying brochure, to the Parliament. The report is titled *Evaluation Processes for the Selection of Hearing Devices*.

Yours sincerely



P. J. Barrett
Auditor-General

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

AUDITING FOR AUSTRALIA

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Abbreviations

AGHS	Australian Government Hearing Services
AGPS	Australian Government Publishing Service
AHS	Australian Hearing Services
ANAO	Australian National Audit Office
ANZ	Australia and New Zealand
BTE	Behind the ear
DAS	Department of Administrative Services
DHFS	Department of Health and Family Services
DoFA	Department of Finance and Administration (includes the former DAS)
HAMADAA	Hearing Aid Manufacturers and Distributors Association of Australia
ITC	In the canal
ITE	In the ear
ITRI	Invitation to Register Interest. An Invitation to Register Interest is generally used at the requirement identification stage to identify the market, available or possible products, services or solutions before soliciting further bids. It can also be used to gather broad information on potential suppliers which may be used to short-list and eliminate uncompetitive bids before soliciting further bids.
NHAS	National Hearing Aid Services Pty Ltd
OHS	Office of Hearing Services
RFO	Request for Offer. This is sometimes called an invitation to treat and is used to solicit tenders, bids or quotations from suppliers.
Service provider	The retail seller of services and devices direct to the client.
Standing Offer	A Standing Offer is a procurement agreement under which a supplier will, during a specified period, provide supplies on specified terms after an order for a specified quantity of the supplies is given to the supplier.
TGA	Therapeutic Goods Administration

Tier structure	A grouping of hearing devices according to their capacity to redress different degrees of hearing loss and other client disabilities. The tier structure recognises the differing clinical needs of clients and the consequential additional cost of more sophisticated devices required to meet more difficult clinical conditions. (See also Appendix 1.)
Top-up aids	The Hearing Services Voucher System provides for clients to have access to a range of high quality hearing aids free or, if they so choose, to purchase an aid with additional features while still getting the benefit of some government subsidy. The latter are known as top-up aids and the payments by the individual client top-up payments.

Part One

Summary and Recommendations

Audit Summary

Background

1. Until November 1997, Australian Hearing Services (AHS), a Commonwealth statutory authority established under the *Hearing Services Act 1991*, was responsible for provision of government funded hearing services and devices. The majority of AHS clients are over 70 years of age and in receipt of government pensions.
2. Following a review of the provision of hearing services, the Government, in August 1996 in the 1996-97 Budget context, announced reforms to the delivery of government funded hearing services. The principal reforms included greater opportunity for service provision by the private sector (as opposed to the use of the private sector under contract through AHS) and the introduction of a voucher system for adult clients of the hearing services program, including consumer choice of service provider. An eligible client is provided with a voucher, the value of which is determined by the clinical assessment of the client's hearing disability. The voucher system allows clients to purchase, from the service provider of choice, a hearing device which is on the list of approved devices.
3. To implement the reforms, the Department of Health and Family Services (DHFS) selected and approved the hearing devices eligible to be supplied to clients under the hearing services program. DHFS invited tenders from manufacturers for the supply of hearing devices which met standards determined by the Department.
4. The Department, with the agreement of the Parliamentary Secretary, adopted a policy of not allowing suppliers of those devices provided free under previous arrangements, access to client payments in addition to government funding. The policy was announced to suppliers some seven days before the closure of the Request for Offer (RFO). This was a relatively short time in which to inform industry of a significant change in the Department's requirements.
5. Government procurement policies advocate that agencies should maximise the Commonwealth's value for money from contractual arrangements. The competitive-tender model is most likely to provide the best price and to minimise pressure on government outlays. The Australian National Office (ANAO) noted that, in this case, the Department, in advising the Minister of the options available, considered that restricting the offer to a single or a small number of suppliers could have a detrimental

effect on the industry and threaten the financial viability of some suppliers. The Department also advised that it may also have been criticised by consumers on the grounds of restricting the range of devices available and the possibility that, as a consequence, there would be increased pressure on consumers to select devices attracting additional consumer payments. The option approved by the Minister was to define the price to be paid by the Commonwealth and to allow all suppliers who wished to offer devices at that price to participate in the scheme.

6. DHFS sought the services of the ANAO to provide the Department with an opinion on the probity of the methodology and procedures applied in the selection of hearing devices while the selection process was in progress. The ANAO did so as an audit related service.

Audit objective and scope

7. The objectives of the audit were to assist DHFS in the timely identification of any deficiencies in the evaluation of responses from suppliers and options for addressing the deficiencies. The ANAO would:

- test the Department's adherence to Commonwealth Procurement Guidelines for open and effective competition and to legislative and other Government specified requirements; and
- provide a report to the Parliament, the Government and other interested parties on the probity of the evaluation process.

8. The scope of the audit was restricted to considering the processes employed by the Department in the selection of hearing devices for use under the voucher scheme.

Audit criteria

9. The ANAO considered whether:

- the evaluation methodologies and procedures developed by the Department reflected Commonwealth Procurement Guidelines¹ for open and effective competition and relevant legislative and other Government specified requirements;
- suppliers were treated ethically, equitably and fairly in the process employed;

¹ Department of Administrative Services 1997, Commonwealth Procurement Guidelines, AGPS Canberra. Replaced in March 1998 by The Department of Finance and Administration, Commonwealth Procurement Guidelines: Core Policies and Principles, <http://www.dofa.gov.au/ctc/cpgs.htm>.

- the evaluation methodologies, as published in the Invitation to Register Interest (ITRI) and the Request for Offer (RFO), were followed and any departures from the methodologies appropriately notified to suppliers;
- appropriate records were maintained;
- decisions were adequately supported and documented; and
- whether the evaluation process would provide confidence that it would result in the selection of appropriate devices.

Audit conclusion

10. The ANAO concluded that Government procurement policies, legislative and other Government specified requirements were properly addressed; appropriate documentation was maintained; and the Department conducted the selection ethically and fairly. The ANAO found the process of evaluating and selecting hearing devices against technical standards to be fair and equitable.

11. The ANAO concluded that the Department's processes were in accordance with Government policies. These included:

- not allowing devices provided free under previous arrangements to attract client payments in addition to government funding; and
- excluding those devices, allowing all other devices offered by suppliers which met the required standards and were supplied at the agreed price, to be included in the list of approved devices which could be purchased by clients with vouchers.

12. The ANAO provided advice on probity issues, orally and in writing, during the course of the evaluation and the Department responded to that advice.

Departmental response

13. The Department provided a number of detailed comments on the report, all of which have been included. The Department indicated that it considered that the report provided a balanced view on the processes examined by the ANAO.

Bernafon response

14. A company, Bernafon, has a major contract to supply hearing devices to AHS. Bernafon is potentially impacted by the Government's reforms and is mentioned several times in the body of this report. The ANAO offered Bernafon the opportunity to comment on those sections where Bernafon was mentioned. Bernafon provided comments and these have been included, where applicable, in the report. The main issue for

Bernafon concerned the difference of opinion between the company and the Department over the minimum number of hearing devices that AHS was required to purchase under the contract.

Part Two

Audit Findings and Conclusions

1. Introduction

This chapter outlines the changes in Government policies leading to the process for selecting hearing devices for inclusion on the list of devices approved by the Office of Hearing Services. The reasons for the audit and the audit objectives and methodology are also outlined.

Government decision

1.1 Following a review of the provision of hearing services, the Government announced, in the 1996-97 Budget context (August 1996), reforms to the delivery of government funded hearing services. The legislative authority for the reforms is contained in two Acts: the *Hearing Services Administration Act 1997* and the *Hearing Services and AGHS Reform Act 1997*.

1.2 The reforms meant that government funded hearing services, previously provided solely by Australian Hearing Services (AHS) (which used private sector contractors), were opened to private sector providers. The reforms have introduced greater private sector involvement in the provision of government funded hearing services, and have involved creating a purchaser/provider split with administrative and regulatory functions handled by the Office of Hearing Services rather than AHS. Under the new arrangements, an eligible client is provided with a voucher the value of which is determined by the clinical assessment of the client's hearing disability. The client may then use the voucher to purchase an approved hearing device from the provider of the client's choice. The voucher system provides for clients to have access to a range of high quality hearing devices free or, if they so choose, to purchase a device with additional features while still getting the benefit of some government subsidy. The latter are known as top-up aids and the payments by the individual client top-up payments.

1.3 In implementing the reforms, DHFS sought offers from suppliers of hearing devices that could be included on a list of approved devices. Initially, the Department invited expressions of interest and then requested offers. In both the Invitation to Register Interest (ITRI) and the Request for Offers (RFO), the Department undertook an evaluation process of devices.

Reason for audit

1.4 DHFS sought the services of the ANAO to provide DHFS with an opinion on the probity of the methodology and procedures applied during the evaluation process. The ANAO undertook to provide ongoing oral advice on probity issues as the occasion demanded and to confirm that advice by letter. On completion of the audit the ANAO expected to provide an opinion on whether the process satisfied Commonwealth Procurement Guidelines and legislative and other Government specified requirements, including whether it was conducted ethically and fairly, and whether the process employed was likely to result in appropriate solutions for the Commonwealth within the policy framework defined by the Minister. The audit did not include any assessment of the technical information in the offers nor ascertain whether the process identified the most appropriate solutions for the Commonwealth. In undertaking the audit, the ANAO notified DHFS that it intended to report to Parliament on the results.

Audit objective, scope and focus

1.5 The objectives of the audit were to assist DHFS in the timely identification of any deficiencies in the evaluation of responses from suppliers and options for addressing the deficiencies. The ANAO would:

- test for adherence to Commonwealth Procurement Guidelines for open and effective competition and to legislative and other Government specified requirements; and
- provide a report to the Parliament, the Government and other interested parties on the probity of the evaluation process.

1.6 The ANAO agreed to undertake the audit in February 1997. During the course of the audit, advice was provided on probity issues both orally and in writing.

1.7 The audit team was not involved in any executive role in the management of the process but was available to provide advice where sought, or where the ANAO perceived deficiencies or was aware of potential conflicts of interest. In addition, it should be emphasised that the audit was directed to the processes employed by DHFS to select suppliers, consistent with Ministerial policy decisions, and not to the technical assessments pertaining to the merits of the selected systems, the perceived cost effectiveness of either the preceding or new systems, whether the voucher system was the most appropriate means of providing hearing services, or whether the Department's administrative processes were efficient.

Audit methodology and criteria

1.8 As part of the audit, criteria were devised to enable the ANAO to assess the methodology and procedures developed by DHFS before it commenced the evaluation, and to assist the ANAO to determine whether the evaluation team adhered to those procedures. The ANAO also considered whether the process was conducted ethically and fairly and, in particular, whether there was the potential for bias and/or conflict of interest. In developing the criteria, the ANAO drew on the experience of earlier audits.

Audit criteria

1.9 The ANAO considered whether:

- the evaluation methodologies and procedures developed by the Department reflected Commonwealth Procurement Guidelines for open and effective competition and relevant legislative and other Government specified requirements;
- suppliers were treated ethically, equitably and fairly in the process employed;
- the evaluation methodologies, as published in the ITRI and the RFO, were followed and any departures from the methodologies appropriately notified to suppliers;
- appropriate records were maintained;
- decisions were adequately supported and documented; and
- the evaluation process would provide confidence that it would result in the selection of appropriate devices.

1.10 In conducting the audit the ANAO:

- examined related files and records held by DHFS and the evaluation team;
- examined the evaluation methodology and procedures;
- observed the conduct of some meetings between DHFS, the evaluation team and respondents to the RFO;
- considered the transparency and fairness of the process;
- considered the commitment of the process to Australian and New Zealand industry development and affirmative action; and
- examined reports on the evaluation, including the final reports.

1.11 During the course of the audit the ANAO attended, as an observer, meetings of the Steering Group/Committee with responsibility for

oversight of the process. Oral reports on matters which the ANAO considered required attention were given to DHFS and later confirmed in writing.

1.12 The audit was conducted as a performance audit under Section 19 of the *Auditor-General Act 1997*. The audit conformed with ANAO Auditing Standards and cost \$142 641, of which \$71 962 was recovered in fees from DHFS. The \$70 679 additional cost above that recovered from DHFS was the cost of reporting to Parliament.

2. Background to the Audit

This chapter describes the previous and new arrangements for the provision of hearing services. By way of background, the process of selection of hearing devices and of the final structure for the provision of devices to clients is also detailed.

Existing arrangements

2.1 Until November 1997, Australian Hearing Services, a Commonwealth statutory authority established under the *Hearing Services Act 1991*, was responsible for provision of government funded hearing services and devices to eligible clients at an estimated cost in 1997-98 of \$87 million. An estimated 3.1 million persons are eligible for services from AHS as defined in the *Hearing Services Act, 1991*.

2.2 In 1995-96 AHS provided services to over 170 000 persons (excluding maintenance services) and fitted 101 300 hearing devices with a further 29 000 fitted by AHS contractors. Supply of devices was guaranteed by entering into contracts with suppliers. In particular a contract was entered into with one company, Bernafon, to supply 50 000-80 000 devices annually. Bernafon is a wholly owned subsidiary of William Demant Holding A/S - formerly Oticon Holding A/S. Bernafon has maintained that AHS is obliged to purchase a minimum of 80 000 devices annually, not 50 000-80 000 as the Department has claimed. The contract with Bernafon included requirements other than the supply of devices to AHS. Amongst the requirements were the development of a new hearing device, local content, the export of 30 000 aids annually, and payment of royalties to AHS.

2.3 AHS was not in competition with the private sector and, under the Constitution, AHS is restricted in the sectors to which it can actively market its services. Open market competition was rejected by the then Government following the then Industry Commission review in 1990 in order to maintain the Government's commitment to the arrangements by which AHS, including the National Acoustics Laboratory, remained the primary provider of Commonwealth hearing concessions. The decision was also based on commitment to the preservation of existing levels of support provided to public interest clients and the cost effectiveness of the program. It also reflected the strongly held preferences of consumer organisations at that time.

The voucher system

2.4 The *Hearing Services Administration Bill 1997* provided for the establishment of a voucher system for the delivery of government funded hearing services from 1 November 1997. Adults wishing to access government funded hearing services must now apply to the Office of Hearing Services (OHS) within DHFS. New applicants must be referred by a medical practitioner. Returning clients may be referred by a qualified hearing services practitioner or medical practitioner.

2.5 Under the Government's reforms, the persons eligible to receive vouchers are:

- a Pensioner Concession Card Holder;
- a person receiving Sickness Allowance from the Department of Social Security;
- a holder of a Gold Repatriation Health Card issued for all conditions;
- a holder of a White Repatriation Health Card issued for conditions that include hearing loss;
- a dependent of a person in one of the above categories;
- a member of the Australian Defence Force; and
- a person undergoing a vocational rehabilitation program with the Commonwealth Rehabilitation Service.

2.6 The Government's policy imperatives were:

- eligible consumers to continue to receive high quality aids free, but to have the choice to purchase an aid with more features and to pay extra for those, yet still to receive the benefit of some government subsidy; and
- the quality of free devices and services provided under the voucher system would be at least equal to that which applied before. Given this, aids which were previously provided free could not attract additional client supplied funding under the voucher system.

2.7 Participants in the voucher system are entitled to one or more specified hearing services including assessment of hearing loss, the provision and fitting of one or more hearing devices (for example, a hearing aid), necessary rehabilitation and adjustment to using the devices, and maintenance and battery replacement. The maintenance and battery replacement is only available to a participant for a \$25 annual contribution (\$20 for dependents). A new voucher will not usually be issued where a voucher covering similar services has been issued in the previous four years.

Australian Hearing Services

2.8 The new voucher system significantly affected the operation of the AHS. AHS now operates as a Commonwealth statutory authority but no longer has exclusive rights to provide government funded services. It is important to note that, as well as competing with private service providers for voucher holders, it must meet community service obligations on behalf of the Government. These include services for children and prescribed public sector clients, hearing and noise related research, and hearing loss prevention activities. In addition, it continues to be the principal hearing services provider for eligible people in certain remote areas, eligible Aboriginal and Torres Strait Islander peoples, and eligible people with complex hearing rehabilitation needs.

Tight deadlines

2.9 The Department was given tight deadlines to implement the new arrangements announced in the 1996-97 Budget. Following the Government's announcement in August 1996, in the 1996-97 Budget context, establishment of a panel of suppliers of hearing devices was expected to be completed by the end of May 1997, OHS was to be operational by April 1997, and the voucher scheme operational from 1 July 1997. The Department considered it was necessary to consult with industry to resolve questions of how the voucher system would operate and to determine prices that were acceptable to suppliers yet budget neutral for the Government. In the event, the voucher system commenced on 1 November 1997. The selection of devices available free to clients was completed at that time. The selection of devices eligible to attract additional client top-up payments was completed in December 1997.

Contractual issues

2.10 Throughout the process, there was uncertainty as to how the changes would affect the existing contract with Bernafon. This contract initially operated from July 1991 to 30 September 1997. The contract included an option to extend the contract and, in December 1995, almost two years before the contract terminated, the contract was extended to 30 September 2002. The 50 000-80 000 devices to be delivered under that contract exceed the estimated 30 000-50 000 devices that will be delivered to clients through the proposed new standing offer arrangements. Including the 50 000-80 000 devices to be delivered to AHS annually by Bernafon under the existing contract, the total size of the subsidised market under the voucher system is estimated at 130 000 devices annually. These numbers demonstrate the existing arrangements between AHS and Bernafon will

continue to provide a large share of government funded devices in the Australian market.

2.11 The ANAO offered Bernafon the opportunity to comment on those paragraphs in which Bernafon was mentioned. The main issue for Bernafon was its contractual arrangements with AHS. In its response, Bernafon stated that it:

has consistently maintained in letters to the Department and others as far back as 1996 that AHS is obliged to purchase a minimum of 80 000 devices annually, not 50 000-80 000 as suggested in (this report).

The ANAO noted that the Department sought legal advice on the Bernafon contract as to the numbers of devices which AHS was committed to purchasing without breaking the contract. That advice was that a minimum AHS purchase of 50 000 units, at the increased price specified in the contract, would be consistent with the latter.

2.12 The ANAO considers the difference between Bernafon and the Department in the number of devices to which AHS is committed to purchasing is one of legal opinion and a matter for those parties to resolve.

2.13 The new arrangements were set in consultation with HAMADA and the hearing reference group. The Department, in advice to the Minister, considered the Bernafon devices supplied through AHS to be relatively sophisticated products which have become the 'benchmark' for devices fitted under the previous arrangements. They effectively raised the standard of the free to client devices which will be provided under the Government's new policy.

Purchasing procedures and policy advice

2.14 The Department sought the advice of the Purchasing Australia Division of the then Department of Administrative Services (DAS) on tendering procedures, the RFO arrangements and Government purchasing policies. DAS received the responses to the ITRI and the RFO on behalf of the Department, and a DAS representative was included on the Steering Group considering the responses to the ITRI.

Legal advice

2.15 The Department obtained legal advice frequently on the Bernafon contract and on evaluation issues. The ANAO is aware of fifteen written legal advices from solicitors external to the Department, and several meetings with external legal advisers, in addition to internal legal advice. A solicitor from a legal firm was appointed to the Steering Committee evaluating responses to the RFO, to provide advice on contractual, probity

and other issues. The Department sought advice from legal staff internal to the Department, private lawyers and the Australian Government Solicitor's office. At the time the voucher system commenced on 1 November 1997 the outstanding legal issues related to top-up devices. The top-up device list was issued in December 1997.

Change in nature of the offer

2.16 Initially the Department released an Invitation to Register Interest (ITRI) with the intention of appointing a restricted number of suppliers with devices supplied at the prices offered by the suppliers. The final strategy was a Standing Offer to which any supplier whose devices met the required standard could be appointed, based on the information provided by suppliers. Prices to be paid for devices were defined by the Department with the approval of the Minister.

2.17 A comparison of the differences between the ITRI and the RFO is as follows.

Table 1
Comparison of ITRI and RFO

	Invitation to Register Interest (ITRI)	Request for Offer (RFO)
Process	Suppliers respond to an Invitation to Register Interest.	Suppliers offer devices to be placed on a list of approved devices.
Explanation of process	An Invitation to Register Interest is generally used at the requirement identification stage to identify the market, available or possible products, services or solutions before soliciting further bids. It can also be used to gather broad information on potential suppliers which may be used to short-list and eliminate uncompetitive bids before soliciting further bids.	A Request for Offer is sometimes called an invitation to treat and is an invitation to potential suppliers to submit offers for the supply of goods and/or services.
Management of process	A Steering Group including DHFS staff and a representative from DAS.	A Steering Committee including DHFS staff and a solicitor from a legal firm.
Evaluation	An evaluation team including DHFS staff and officers from CSIRO and TGA.	An evaluation team including DHFS staff, a DHFS contractor and an officer from CSIRO.
Result of process	Information from industry gathered. All suppliers allowed to bid in the RFO.	All devices meeting the required standard are listed as approved devices on a Standing Offer. A Standing Offer is a procurement agreement under which a supplier will, during a specified period, provide supplies on specified terms after an order for a specified quantity of the supplies is given to the supplier.

2.18 The ITRI, which closed in March 1997, sought information and pricing with the intention of proceeding to a restricted list of suppliers. Value for money, particularly in the pricing of devices, would be a major determinant of devices selected. Thirteen suppliers responded to the ITRI. The team evaluating the responses had difficulties with inconsistent and, at times, inadequate levels of information provided in responses to the ITRI. The team was unable to assess whether any of the respondents would be unable to meet the requirements of the tender. Accordingly all of the respondents were allowed to bid in the subsequent RFO.

2.19 On completion of the ITRI, the evaluation team recommended that a Request for Tender not be issued until a number of policy issues were resolved. The departmental Steering Group accepted the recommendation.

2.20 Subsequently, following representations from industry, a significantly different approach was adopted. Rather than seek tenders from suppliers on a competitive pricing basis, a tier structure was adopted with the tiers defined to address a clinical need.

2.21 Suppliers were then invited to respond to an RFO. Technical specifications were defined for each tier and any offered device which met those specifications was eligible for inclusion in the tier. The prices to be paid for each tier were defined and suppliers were not competing on price. Suppliers had the option of offering devices at the price defined in the RFO, offering devices with features that made them eligible for top-up charges, or being excluded from the government funded list of approved devices.

Tier structure and top-up

2.22 The tier structure was developed in May and June 1997. The structure recognises the differing clinical needs of clients and the consequent additional cost of more sophisticated devices required to meet more difficult clinical conditions. The structure was developed with the involvement and advice of industry. Appendix 1 details the final tier structure and prices paid, through the voucher system, for each tier. The prices vary from \$250 for tier 1 devices for clients with mild to severe levels of hearing loss, up to \$400 for non-standard tier 3c devices. In addition there was provision for suppliers offering devices with additional features to obtain client funded 'top-up' payments. That is an additional payment beyond that defined in the tier structure. 'Top-up' devices are included in the OHS list of approved devices. However, the client must elect to pay the additional cost of the device, rather than government funding the additional amount. Devices approved for the top-up list are first required to meet the appropriate standard of the tier list.

Table 2
Summary of tier structure

Tier 1	\$250	Tier 3a	\$295
Mild to severe hearing loss		As for Tier 1 and includes a form of compression which removes the need for a manual volume control	
Tier 2	\$300	Tier 3b	\$340
Severe to profound hearing loss		As for Tier 2 and includes a form of compression which removes the need for a manual volume control	
		Tier 3c	Individual prices to a maximum of \$400
		Non-standard devices not covered in other tiers.	

Top-up and previously free to client devices

2.23 The Department, in a letter clarifying its RFO, stated that devices previously provided free to clients as at the 12 September 1997, and previously provided free to clients under the hearing services program would not be considered for top-up. This was to ensure that the same level of free services available in the previous arrangement would be provided under the voucher system. Suppliers who had nominated devices for top-up which had previously been provided free were given the option to place these devices into the tier structure. A number of suppliers took up this option.

2.24 Bernafon sought top-up listing for 11 devices and was successful with one. Subsequently, the Department offered Bernafon the option of placing its devices in the tier structure. Bernafon accepted this option for one of its devices whilst lodging an application to the Minister, consistent with the provisions in Section 29 of the *Hearing Services Administration Act 1997*, for reconsideration of the Minister's decision for all of the rejected devices. Bernafon later was successful in placing a number of new devices on the top-up list and withdrew the appeal. AHS continues to deliver the Bernafon devices under the existing contract at an average cost to government below that provided for in the voucher system.

2.25 A small number of existing devices was exempted from the above consideration on the basis that they were approved in anticipation of the introduction of the voucher system.

3. Processes Examined

This chapter provides a brief description of the processes examined by the ANAO during the course of the audit and provides an audit opinion for each process.

Overall audit opinion

3.1 Government procurement policies, legislative and other Government specified requirements were properly addressed, appropriate documentation was maintained and the Department conducted the selection process ethically and fairly. The ANAO found the process of evaluating and selecting hearing devices against technical standards to be fair and equitable.

3.2 The ANAO concluded that the Department's processes were in accordance with Government policies. These included:

- not allowing devices provided free under previous arrangements to attract client payments in addition to government funding; and
- excluding those devices, allowing all other devices offered by suppliers, which met the required standards and were supplied at the agreed price, to be included in the list of approved devices which could be purchased by clients with vouchers.

3.3 The ANAO provided advice on probity issues, orally and in writing, during the course of the evaluation and the Department responded to that advice.

The Department's methodology and procedures

3.4 Both the published ITRI and RFO included an outline of how responses would be evaluated. A more detailed methodology, consistent with that published, was developed to guide the departmental evaluation team. The ANAO examined and commented on all evaluation methodologies and considered them appropriate for the requirement.

Conflict of interest

3.5 Members of the RFO Steering Committee and evaluation team signed a form declaring they had no conflict of interest.

3.6 The ANAO noted that the Department took steps to ensure that the AHS was not placed in a conflict of interest situation. Where technical advice was required that was not available in Australia other than within

AHS, the National Audiology Centre in New Zealand was nominated by the Department as its adviser.

3.7 The ANAO considers the Department took appropriate steps to ensure that personnel involved in the selection of hearing devices had no conflicts of interest, and the ANAO did not observe any conflict of interest.

Late responses

3.8 The RFO stated 'Offers lodged after the closing time for the lodgement of offers will not be accepted'. Subsequently, a clarification letter sent to suppliers before closure of the RFO stated that offers would be accepted after the closing date. The clarification letter stated that the Department would take all reasonable steps to evaluate responses received after the closing date but did not undertake to process these by 1 November 1997.

3.9 One response to the RFO was about 20 minutes late and, on the advice of DAS, was accepted for evaluation. All responses were evaluated to enable the distribution of a list of free devices before the launch of the voucher system on 1 November 1997.

3.10 The ANAO considers the acceptance of the late response was in accordance with the revised conditions of the offer as advised in the clarification letter.

The Invitation to Register Interest

3.11 The ITRI was issued on 19 February 1997 and closed on 21 March 1997. Thirteen responses were received and were evaluated by a team of four which included an electrical engineer currently working as a research scientist with the CSIRO, and a biomedical engineer from the medical devices section of the Therapeutic Goods Administration (TGA). The Department supplied one member and the chair of the team. The Department's invitation to the ANAO to participate in the process was too late for the ANAO to provide advice or comment on the ITRI document.

3.12 The team evaluating responses to the ITRI reported that:

the information provided by respondents was generally insufficient to enable a full and critical assessment against the various selection criteria. Accordingly the team is unable to assess whether any of the respondents would be unable to meet the anticipated requirements of the tender.' The team acknowledged that 'part of the difficulty relates to the structure and approach adopted in presenting the draft device specifications'. The team also noted 'the likely paucity of programmable/digital devices that might be considered equivalent to the range of aids currently serving as the principle product provided by Australian Hearing Services.

Bernafon had, at that stage, indicated that it would not be offering this product range for supply under the proposed arrangements. The evaluation team stated that the ITRI could have been better structured to meet the perceived requirements of the Department.

3.13 The team recommended clarification of some policy issues before proceeding to the next phase of the process.

3.14 The ANAO noted that the Department considered that the purpose of the ITRI was to gather information about suppliers interested in the proposed tender, their capacity to meet the Department's requirements, and information to help assess the budgetary consequences of industry pricing policies. The Department considered this had been broadly achieved notwithstanding the difficulties arising from the limited levels of detail provided by respondents.

3.15 During and following the ITRI process, the ANAO was not advised of some meetings with industry concerning the process. As a result, the ANAO did not have the opportunity to attend an industry briefing and some industry debriefings. The ANAO wrote to the Department advising of the importance of being given timely advice of crucial steps in the process and that omissions could affect the ANAO's ability to provide an audit opinion on the probity of the process. During the RFO process the ANAO also became aware of at least one further meeting with a respondent after the meeting occurred. The Department advised the ANAO:

The Department highlighted that care was taken to ensure that issues related to the process of the RFO were not discussed with the suppliers concerned. It should also be noted that the conditions of the evaluation of the RFO allowed the Department to seek further information or enter into negotiations with individual suppliers.

3.16 The ANAO considered that the ITRI process was managed by an appropriate Committee Structure and appropriate evaluation team members.

3.17 While the process did not succeed in one purpose, that of reducing the number of qualifying suppliers, later changes of strategy which allowed all devices which satisfied DHFS standards to be approved meant that this did not adversely affect the probity of the process.

3.18 The information provided in the responses to the ITRI allowed the Department to develop a more suitable policy for the next stages of the selection process.

The Request for Offer (RFO)

3.19 The RFO was advertised and released on 13 September 1997 and closed on 3 October 1997. An industry briefing was held on 22 September 1997. On 26 September 1997 two clarification letters and an addendum to the RFO were sent to suppliers. The letters and addendum of the 26 September were clearly intended to modify the RFO document, and later legal advice to the Department was that the expanded RFO comprised the documents as a whole.

3.20 The RFO was significantly changed by the addendum and letters:

- late offers were now accepted rather than absolutely rejected, there was and is no time limit on acceptance of late offers;
- potential suppliers were advised that devices on the existing approved list on 12 September 1997 would not be accepted for top-up. However, respondents who believed they had a special case were invited to put their case to the Department.

3.21 In response to the RFO, sixteen suppliers offered 944 devices.

3.22 A Steering Committee of two departmental Senior Executives, the head of the Department's Internal Audit Branch, an external lawyer and the head of the evaluation team oversaw the evaluation. The ANAO attended Committee meetings as an observer.

3.23 The ANAO considered that the RFO process was managed by a suitable Committee Structure with appropriate evaluation team members.

RFO evaluation reports

3.24 The offers were evaluated by a team of three: a departmental representative, an audiologist contracted to the Department and the research scientist from CSIRO who was involved in the evaluation of the ITRI. The evaluation team reported to the Steering Committee regularly on progress. All recommendations of the evaluation team were considered by the Steering Committee. The ANAO observed the operation of the Steering Committee and noted it fully discussed the reports of the evaluation team and requested additional information on several occasions.

3.25 The listing of devices into tiers was approved by the departmental delegate and the Parliamentary Secretary was advised. Due to the sensitivity of the listing of the top-up devices, the Parliamentary Secretary exercised her delegation to approve the list for and on behalf of the Minister.

3.26 The ANAO considers that the Steering Committee took appropriate steps to ensure it was fully informed of the rationale behind the recommendations of the evaluation team. The Committee took appropriate responsibility for providing advice and recommendations to the Minister approving the listing of devices into tiers and the top-up list.

Testing of devices

3.27 The evaluation methodology provided for test reports supplied by manufacturers of devices to be accepted unless it was clear that testing was not carried out as defined in DHFS' Specifications for Classes of Hearing Device. Devices that were on the approved list as at 12 September 1997 had previously been approved against the device standards. Therefore, test reports were not required for those devices as long as they met the revised distortion requirements. New devices (that is those devices not on the approved list as at 12 September 1997) had to be submitted with test reports from their own in-house testing facility or from an independent reviewer such as AHS or the New Zealand Audiology Centre. The ANAO was advised that one supplier had sought the services of AHS to conduct tests.

3.28 The Department planned to test a small number of randomly selected devices against the defined standard. The RFO evaluation methodology stated:

Technical issues that may, in the opinion of the Committee, need further clarification but which are beyond the expertise of the Committee, will be referred to the National Audiology Centre in New Zealand, or other experts/ organisations with expertise in hearing device testing and/or technology.

3.29 In the event the Department accepted all records of tests provided by suppliers as valid. At the time of this report the testing of providers claims for the specifications and clinical effectiveness of devices had not commenced.

List of tier devices

3.30 In late October 1997, respondents to the RFO were advised of the list of devices and the tier to which they were allocated. The final list was announced on 1 November 1997 at which time fourteen of the sixteen suppliers had signed their deed of appointment, one had agreed to sign and clarification was being sought from one other supplier.

Top-up arrangements

3.31 Following the announcement of devices included in the tier list, the Department concentrated on determining which devices were eligible to be placed on the top-up list. The RFO had indicated the additional features that could be considered for determining the eligibility of a device for top-up. The RFO also stated that the additional features must have a demonstrable client benefit. A total of 136 devices was offered for top-up listing.

3.32 Suppliers were also advised that devices that had previously been approved and supplied free through the hearing services program would not be considered for top-up status. However, with legal advice, the Department agreed that certain devices which had been approved in anticipation of the new arrangements would be considered for top-up.

3.33 One feature nominated in the RFO as a feature which could be considered for top-up eligibility was multi-memory. Multi-memory is a feature which allows the user of a device to select different programs for different noise situations. However, the Bernafon aid, provided to AHS clients free of charge, included multi-memory. The Department therefore considered that, as some 50 000-80 000 devices sold were provided with the feature, multi-memory alone was insufficient to justify top-up status for devices. The ANAO noted that, at the time of this decision, if the Bernafon devices provided through AHS were excluded from consideration, only one device on the tier list (in tier 3c) included multi-memory. The ANAO noted that the Department obtained and followed legal advice on this point.

3.34 The Department advised the ANAO that:

multi-memory devices with three or more programs have been approved for top-up and that the Bernafon aid provided through AHS has two programs.

3.35 The policy decision not to allow devices supplied under the previous arrangements eligibility for additional top-up listing was announced to suppliers some seven days before the closure of the RFO. The Department sought and followed legal advice on the issue.

Open and effective competition

3.36 The decision of the Department to allow all responses to the ITRI to proceed to further stages ensured competition was not restricted. The nature of the RFO, where the Department, with the approval of the Minister, set the prices offered for tiers and allowed all devices meeting the set standard to be included within the standing offer arrangements, means open and effective competition is not an issue. All devices offered which

met the standards were accepted for inclusion in the Standing Offer. The Standing Offer also allowed for the inclusion of any additional devices from Appointed Suppliers for the period of the offer, and also allowed suppliers to withdraw devices from the offer.

3.37 The competitive-tender model is most likely to provide the best price and to minimise pressure on government outlays. The ANAO noted that, in this case, the Department, in advising the Minister of the options available, considered that restricting the offer to a single or a small number of suppliers could have a detrimental effect on the industry and threaten the financial viability of some suppliers. While this model would have been welcomed by individual manufacturers which expected to be successful, it may have been criticised by the broader industry and by those who were not successful. The Department also advised that it may also have been criticised by consumers on the basis of restricting the range of devices available and the possibility that, as a consequence, there would be increased pressure on consumers to select devices attracting additional consumer payments. The option approved by the Parliamentary Secretary for and on behalf of the Minister, was to define the price to be paid by the Commonwealth and to allow all suppliers who wished to offer devices at that price to participate in the scheme.

3.38 The ANAO noted that the decision not to proceed to competitive tender was made by the Parliamentary Secretary for and on behalf of the Minister on departmental advice.

Australian Government policies

3.39 The RFO sought information regarding ANZ maintenance and repair facilities, and advised respondents of Government policies in regard to affirmative action, Aboriginals and Torres Strait Islanders, and Australian and New Zealand industry. These policies were not considered mandatory requirements and were not assessed in the evaluation. The policy, as advised by the Department of Finance and Administration (DoFA, previously DAS) was that assessment must not be biased against ANZ industry. As the assessment of devices was against a technical standard that was not biased against Aboriginal and Torres Strait Islander policies or against ANZ industry policies, the process complied with Government policies.

3.40 The evaluation team verified that successful suppliers were not named by the Affirmative Action Agency as failing to comply with the *Affirmative Action Act*.

3.41 In summary, the ANAO considers that the process complied with the Government's policies on Aboriginals and Torres Strait Islanders, ANZ industry and affirmative action.

Canberra ACT
29 June 1998



P.J. Barrett
Auditor-General

Part Three

Appendices

Appendix 1

Device and Tiering Pricing Structure

From 1 November 1997, Appointed Suppliers will provide devices to Contractors in accordance with the Device Tiering and Pricing Structure below.

The prices payable by the Office (OHS) to Contractors in respect of devices that will be free to clients will be the prices set by the Office for the individual tiers of the tiering structure below. A list of devices that will be free to clients will be provided to contractors.

Tier	Description of Devices	Price
1	<p>These devices (ITC, ITE, BTE devices) are intended for people with three frequency average (3FA) hearing losses (average of 500, 1000, 2000 Hz) less than 70 dB HL, but may be used for people with a greater degree of hearing loss.</p> <p>The devices must include the following performance features:</p> <ul style="list-style-type: none"> • low distortion, achieved with either output controlled or other compression limiting to control device MPO, or other technology that meets the distortion specification; • two fitter adjustments, subject to size constraints in custom devices; • the availability of fitter adjustments of MPO, frequency response or gain, at no additional cost; • the availability of a telecoil and telecoil selector switch at no additional cost. 	\$250
2	<p>These devices (primarily BTE devices, but potentially ITE devices) are intended only for people with 3FA hearing losses equal to or greater than 70db HL.</p> <p>The devices must include the following performance features:</p> <ul style="list-style-type: none"> • a fitter adjustment of MPO; • fitter adjustment of frequency response or gain; • a telecoil and telecoil selector switch (not mandatory for custom devices); • electrical audio input (not mandatory for custom devices). 	\$300
3a	<p>These devices (ITC, ITE, BTE devices) are only for people who cannot operate a volume control, and are intended for people with 3FA hearing losses less than 70 db HL, but may be used for people with a greater degree of hearing loss.</p> <p>The devices must meet all the requirements of Tier 1, plus a form of compression that largely removes the need for a manual volume control. At any frequency, the output must vary by 20 dB or less as the input varies from 50 to 90 dB SPL, and the compression ratio must be less than 5:1 for all input levels less than 70 dB SPL.</p> <p>A telecoil and telecoil selector switch can be added to a Tier 3a device at no additional cost</p>	\$295

Tier	Description of Devices	Price
3b	<p>These devices (primarily BTE devices, but potentially ITE devices) are intended only for people with 3FA losses equal to or greater than 70 dB HL and who cannot operate a volume control.</p> <p>The devices must meet all the requirements of Tier 2, plus a form of compression that largely removes the need for a manual volume control. At any frequency, the output must vary by 20 dB or less as the input varies from 50 to 90 dB SPL, and the compression ratio must be less than 5:1 for all input levels less than 70 dB SPL.</p>	\$340
3c	<p>These devices are for clients who have non-standard needs not covered by the devices in other tiers. It is anticipated that there may be separate prices for each of the types of devices included in this category.</p> <p>These types will include, but are not limited to:</p> <ul style="list-style-type: none"> • bone conducting devices; • CROS devices (including BICROS, STEREO CROS); • body and spectacle devices; • ALDs. 	<i>Individual price to be agreed up to a maximum of \$400</i>

Top-Up Pricing Structure

The price that will be paid to a Contractor for a top-up device will be determined by the Office against the tier of device that would ordinarily have met the Client's hearing needs. The Client will be required to pay the balance of the costs.

All top-up devices must contain some additional feature(s) that must have a demonstrable Client benefit.

These additional features could include, but are not limited to:

- a) CIC style hearing aid
- b) compression that removes the need for a manual volume control, for those cases where a client would be able to operate a volume control but would prefer not to use one;
- c) multi-memory;
- d) multi-band compression;
- e) directional microphones;
- f) multi-microphones.

Appendix 2

Performance Audits in the Health and Family Services Portfolio

Set out below are the titles of the reports of the main performance audits by the ANAO in the Health and Family Services portfolio tabled in the Parliament in recent years.

Audit Report No.19 1994-95
 Efficiency Audit
Validation of Nursing Home Funding
 Department of Human Services and Health

Audit Report No.5 1995-96
Provision of Hearing Services
 Australian Hearing Services

Audit Report No.18 1995-96
 CETP
 Department of Health and Family Services

Audit Report No.24 1995-96
Impact of Sunset Clause on Investigatory Powers
 Health Insurance Commission

Report No.8 1996-97
Drug Evaluation by the Therapeutic Goods Administration
 Department of Health and Family Services

Report No.31 1996-97
Medifraud and Inappropriate Practice
 Health Insurance Commission

Report No.12 1997-98
Pharmaceutical Benefits Scheme
 Department of Health and Family Services

Audit Report No.45 Performance Audit
Planning for Rural Health
 Department of Health and Family Services

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- Audit Report No.9 Performance Audit
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Strategic and Operational Management
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