

The Auditor-General
Audit Report No.25 1999–2000
Performance Audit

Commonwealth Electricity Procurement

Australian Greenhouse Office
Commonwealth Scientific and Industrial Research
Organisation
Department of Defence
Department of Finance and Administration

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Canberra ACT
5 January 2000

Dear Madam President
Dear Mr Speaker

The Australian National Audit Office has undertaken a performance audit in the Australian Greenhouse Office, the Commonwealth Scientific and Industrial Research Organisation, the Department of Defence and the Department of Finance and Administration 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 *Commonwealth Electricity Procurement*.

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

Yours sincerely



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

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

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Acronyms and abbreviations

AGO	Australian Greenhouse Office
ANAO	Australian National Audit Office
CAC agencies	Commonwealth agencies subject to the <i>Commonwealth Authorities and Companies Act</i>
CSIRO	Commonwealth Scientific and Industrial Research Organisation
Defence	Department of Defence
DISR	Department of Industry, Science and Resources
DOFA	Department of Finance and Administration
EESU	Energy and Environmental Services Unit (now Government Operations Team in the AGO)
FMA	<i>Financial Management and Accountability Act 1997</i>
FMAR	Financial Management and Accountability Regulations
GOT	Government Operations Team of the AGO. Previously EESU
JCPAA	Joint Committee of Public Accounts and Audit
JCPAA Report	Joint Committee of Public Accounts and Audit Report No. 369, <i>Australian Government Procurement</i> , June 1999
NEC	National Electricity Code (the Code)
NECA	National Electricity Code Administrator
NEM	National Electricity Market
NEMMCO	National Electricity Market Management Company
NSW	New South Wales
NT	Northern Territory
SA	South Australia
The Code	The National Electricity Code
The Guidelines	<i>Commonwealth Procurement Guidelines: Core Policies and Principles (March 1998)</i>
VAS	Value-added-services
VFM	Value-for-money
WA	Western Australia

Glossary

Energy use profile: Historical use of electricity, usually presented in graphs or tables that detail hourly, daily, weekly or seasonal variations in electricity use. This information is known in the electricity industry as an electricity load profile.

Network system: Electricity power lines and associated infrastructure that convey and control the conveyance of electricity between generators and customers' premises, not including any power lines or associated infrastructure in a transmission system.

Eligible site: An agency property or site that can participate in the deregulated electricity market. Eligibility is based on the annual level of electricity use. Entry into the NEM has been based on a national schedule agreed by all governments.

National Electricity Code Administrator (NECA): Monitors adherence to, and efficacy of, the NEC. When necessary, the NECA seeks Australian Competition and Consumer Commission approval of changes to the Code.

National Electricity Market (NEM): Wholesale electricity market where generators and large electricity customers trade according to NEC rules. Encompasses electricity sales in New South Wales, Victoria, Queensland and South Australia. The NEM operates according to rules set down in the NEC.

National Electricity Market Management Company (NEMMCO): Manages the NEM and operates the electricity spot market (or pool) where generators bid prices to meet anticipated electricity demand over half-hourly periods.

Summary and Recommendations

Summary

Introduction

1. The deregulation of retail trading in the Australian electricity market from 1995 has resulted in competition between generators and retailers in a National Electricity Market (NEM), which encompasses New South Wales, Victoria, Queensland, South Australia and the Australian Capital Territory. Consumers meeting specified annual electricity consumption levels have been able to negotiate electricity supply contracts with NEM-licensed electricity retailers. Between 1995 and 1999, significantly lower electricity prices for consumers (than those available before deregulation) have been negotiated. Many Commonwealth agencies have taken advantage of these lower prices. In 1999, prices have been increasing but remain significantly less than pre-deregulation tariffs.
2. Although not included in the NEM in 1999, Western Australia, Tasmania and the Northern Territory are pursuing their own electricity reforms. Commonwealth agencies are acting to negotiate agreements for better electricity prices in these regions.

Audit objective, scope and focus

3. The objective of this audit was to form an opinion on the adequacy of, and to identify best practice in, Commonwealth agencies' electricity procurement systems and procedures. In doing so, the ANAO also formed an opinion on the level and results of participation by Commonwealth agencies in the NEM. The audit concentrated on adherence by agencies to the principles of the Commonwealth Procurement Guidelines: Core Policies and Principles (March 1998) (the Guidelines), emphasising the importance of Commonwealth agencies achieving value-for-money (VFM) in their purchasing. VFM is one of the six principles on which the Guidelines are based. These are listed in paragraph 6.
4. The Guidelines are enabled by the Financial Management and Accountability Regulations (FMAR). Agencies subject to the Financial Management and Accountability (FMA) Act must have regard to these regulations in relation to the procurement of property or services. While not applicable to all Commonwealth bodies, the Guidelines provide a sound framework and useful guidance for procurement activity.

5. The objective and focus of the audit are consistent with the Joint Committee of Public Accounts and Audit (JCPAA) Report No.369, *Australian Government Procurement*, June 1999, which:

- recommended that the ANAO increase the number of performance audits of the purchasing function; and
- suggested that chief executive officers ensure that the VFM principle is applied correctly.

Audit approach, criteria and methodology

6. A case-study approach was used for this audit. Three studies were conducted—a multi-agency electricity supply contract in the ACT; a recent Commonwealth Scientific and Industrial Research Organisation (CSIRO) electricity-supply contract; and five electricity-supply contracts negotiated by the Department of Defence. Most of the agencies involved in the ACT contract and the Department of Defence are FMA agencies; CSIRO is a body subject to the Commonwealth Authorities and Companies (CAC) Act. The criteria used to examine each case study were based on a checklist developed by the ANAO from the six principles on which the Guidelines are based. The six principles are:

- value-for-money;
- open and effective competition;
- ethics and fair dealing;
- accountability and reporting;
- national competitiveness and industry development; and
- support for other Commonwealth policies.

7. In each case study, the chronological events, key participants, key documents and the results of examinations of electricity contracts were identified, documented and examined against the criteria. Case studies were selected to include:

- the activities of large agencies with sites that were able to participate in the deregulated electricity market (these are termed ‘eligible sites’ in this report) in all the states participating in the NEM;
- smaller agencies with eligible sites, predominantly in the ACT; and
- a range of contracts and contracting situations, before and since deregulation began, which allowed examination of how contracts and procedures had developed.

Audit opinion

8. The ANAO considers that:

- electricity procurement systems and procedures used by the case study agencies have been effective and efficient (in terms of the savings achieved compared to the cost of negotiating and managing contracts) and consistent with the majority of the Guideline's requirements;
- there has been a high level of participation by Commonwealth agencies in the NEM between 1996 and 1999, as opportunities have become available;
- the negotiation by Commonwealth agencies of lower electricity prices has resulted in significant savings in the cost of electricity; however,
- not all Commonwealth agencies which should have negotiated electricity supply contracts have done so. Therefore opportunities for wider participation in the NEM, and more likely savings, remain.

9. The ANAO estimated that in 1997–98 Commonwealth expenditure on electricity was \$110–\$120 million, of which \$60–\$70 million is estimated to have been incurred at sites able to participate in the NEM. Savings of about \$11 million over pre-deregulation expenditure have been achieved. This estimate is based on Commonwealth-wide energy use data and on case-study agency electricity contract information.

10. The ANAO has made four recommendations addressing agency participation in the NEM and systems and procedures which would assist in maximising VFM. The recommendations address procurement preparation, collaborative procurement and more efficient Commonwealth-wide information acquisition and distribution through the Australian Greenhouse Office.

Key Findings

Commonwealth agencies' participation in the NEM

11. The ANAO found that:

- all portfolios with eligible sites have taken advantage of the opportunities made available by the NEM;
- eligible sites existed in the ACT that were not on contracts. Consequently, the ANAO considers it likely that there are still a number of eligible Commonwealth sites in NSW, Victoria and Queensland that have not been placed on supply contracts; and
- accurately defining Commonwealth agency participation in the NEM and the level of savings achieved is not possible due to several factors including:
 - the lack of a whole-of-government function regarding electricity procurement;
 - inadequate property registers; and
 - the incompatible electricity billing and payment arrangements used by agencies and electricity retailers.

Adherence to the Commonwealth Procurement Guidelines

12. The ANAO considers that in procuring electricity in the deregulated electricity market the case-study agencies have:

- achieved better value-for-money than was being achieved before deregulation;
- fulfilled their obligation to support open and effective competition;
- satisfied requirements for ethical behaviour and fair dealing in the tendering and contracting process;
- differed in the extent to which they conformed with accountability and reporting obligations; and
- generally met national competitiveness and industry-development obligations by participating in the National Electricity Market.

Achieving value-for-money in electricity procurement

Obtaining the best price and quality

13. The case-study agencies used price as the main criterion when selecting electricity retailers. Prices have been negotiated that were 20–40 per cent less than ‘general tariffs’ (ie. prices applying to sites ineligible for the NEM).

14. In the NEM the retailers are not in a position to guarantee the quality aspects of electricity supply. It is the National Electricity Market Management Company’s and the National Electricity Code Administrator’s responsibility to take all reasonable steps to ensure quality aspects of electricity supply. As a consequence, agencies should assess the risks to their programs should the electricity being supplied be disrupted, and decide whether additional arrangements are required.

Information for obtaining the best price

15. Those agencies with the best information in regard to their current and future electricity requirements, electricity prices and future electricity demand-supply trends were in the best position to negotiate the best price.

Electricity price trends and the implications regarding savings

16. Advice from the case-study agencies indicates that the price fluctuations in the NEM are expected to stabilise as retailers and generators adjust their operations in the light of market experience. In addition, the significant price reductions experienced between 1996 and 1998 are unlikely to be available when future contracts are negotiated. Therefore, these changes in the NEM will place greater emphasis on agencies achieving value-for-money from areas other than price including:

- increasing buying power through bulk-buying;
- improvements in value-added-services; and
- achieving greater efficiencies in electricity use, resulting in less electricity being consumed.

Maximising value-added-services

17. Value-added-services such as enhanced billing information and arrangements, reviews and reports and energy-efficiency/conservation examination and analysis were negotiated in the case-study contractual arrangements. The information arising from these services is of particular value when analysing energy use as part of agency energy conservation activities. Analysis of such information can lead to the identification of

periods of excessive electricity consumption (eg. after hours) and/or times of day at which electricity use could be adjusted to take advantage of price variations.

18. In some cases the full value that was expected when contracts were negotiated has not been achieved. Reasons for this include agencies changing their requirements and retailers not supplying the contracted value-added-services (VAS).

Contract development and protecting the Commonwealth's interests

19. In general, the electricity procurement exercises examined resulted in electricity-supply contracts of mixed quality. However, the standard of contracts has significantly improved over time, particularly in terms of the inclusion of standard and special purpose clauses.

20. Similar improvements in quality have occurred in procurement processes. That is, procurement systems and procedures for earlier procurements were less well developed, in terms of formal structure, than those now applying. The greater level of formality has led to better preparation of tender documents, risk assessments and contract-management arrangements.

The procurement process and arrangements

21. Commonwealth agencies, that are large consumers of electricity, are able to benefit from economies of scale in arranging bulk electricity purchases. Smaller agencies can also benefit from economies of scale by buying electricity in collaboration with other agencies.

22. The Department of Defence has negotiated clauses in its electricity supply contracts that allow other Commonwealth agencies to take advantage of the price, terms and conditions achieved by Defence. CSIRO has not yet taken the same approach, but intends to. The Australian Greenhouse Office (AGO) was found to be promoting the inclusion of such clauses. The AGO advised that other agencies including state government agencies have negotiated such clauses.

The role of the Australian Greenhouse Office

23. The ANAO considers that the whole-of-government electricity procurement advisory activities of the Australian Greenhouse Office (through the Government Operations Team) were cost effective and have resulted in better value-for-money being achieved Commonwealth-agency wide in electricity procurement. The ANAO considers that the AGO has an important continuing role to play in support of Commonwealth-wide electricity procurement activities, for example, in assisting agencies to

identify their electricity needs and coordinating electricity supply contract arrangements.

Open and effective competition

24. All electricity retailers were given the opportunity to compete for the case-study electricity contracts of CSIRO and Defence.

25. DOFA's case study involved a pre-NEM contract. At the time, only one retailer was legally able to negotiate an electricity-supply contract; consequently there was no requirement to conduct a tendering process.

Ethics and fair dealing

26. The ANAO found that the case-study agencies satisfied the requirements for ethical behaviour and fair dealing in the tendering and contracting process. Specifically the files examined indicated that:

- retailers were dealt with equitably;
- commercially sensitive information was kept secure;
- care was taken in the use of public moneys; and
- the various responsibilities and authorisations in procurement were separated in the case-study agencies.

Accountability and reporting

27. Each of the case-study agencies were found to have adequate records dealing with procurement plans, decisions and associated activities. In particular, records were identified that covered matters such as:

- the selection criteria on which evaluation and selection decisions were based;
- agreements reached with suppliers during negotiations;
- records of contractors' performance; and
- billing and account-payment activities confirming that reduced prices were in effect.

28. The accessibility and completeness of CSIRO and Defence's records were sound. Initially, DOFA's files were incomplete with limited information being included which documented the procurement process. This situation was substantially remedied during the course of the audit after documents which existed in a number of locations, including a consultant's office and private officers' files, were consolidated.

29. CSIRO and DOFA did not meet the Guidelines requirement that procurements be reported through the Telstra Transigo facility. It was evident that the responsible staff in some agencies did not understand, or necessarily know of, this requirement.

Support for national competitiveness, and industry development

30. The case-study agencies met their national competitiveness and industry-development obligations by participating in the NEM.

Recommendations

Set out below are the ANAO's recommendations. The AGO, CSIRO, Defence and DOFA have commented on Recommendation Nos. 1, 2 and 3. Recommendation No. 4 involves only the AGO and therefore only the AGO has commented. The ANAO considers that all recommendations warrant the same priority.

Recommendation No.1
Para. 2.18 The ANAO recommends that all Commonwealth agencies with eligible sites, that are not presently participating in the National Electricity Market, take appropriate steps, where cost effective, to do so.

All agencies: Agreed

Recommendation No.2
Para. 3.18 The ANAO recommends all Commonwealth agencies should have systems and procedures to ensure that:

- (a) electricity-consumption patterns and future requirements are determined and revised at appropriate times; and
- (b) an appropriate level of knowledge of the National Electricity Market and a general understanding of its implications are available for negotiating electricity contracts.

All agencies: Agreed

Recommendation No.3
Para. 3.57 The ANAO recommends that:

- (a) larger Commonwealth agencies which unilaterally negotiate their own electricity supply contracts seek to negotiate a contract clause which allows other Commonwealth agencies to become party to the same contract and negotiated prices; and
- (b) smaller Commonwealth agencies, when entering the National Electricity Market, consider joining other Commonwealth agency contracts as a cost-efficient procurement option.

CSIRO, Defence and DOFA response: Agreed

AGO's response: Agreed in principle

Recommendation No.4
Para. 3.68 The ANAO recommends that the Australian Greenhouse Office, through its Government Operations Team:

- (a) acquire and distribute National Electricity Market information relevant to participating Commonwealth agencies;
- (b) maintain and distribute a list of Commonwealth agency electricity supply contracts which incorporate clauses allowing other agencies to take advantage of the same terms and conditions of electricity supply;
- (c) negotiate further electricity supply contracts for small and medium size Commonwealth agencies as the opportunities arise and where the electricity contract terms and conditions of other Government agencies are inappropriate; and
- (d) develop a best practice guide for electricity supply contracts.

AGO's response: Agreed

Audit Findings and Conclusions

1. Introduction

This Chapter outlines the audit's objectives and methodology. It also identifies the estimated value of the Commonwealth's annual electricity procurement and the basis of selection of the case studies from which the audit's conclusions are drawn.

Background

1.1 The deregulation of retail trading in the Australian electricity market from 1995 has resulted in competition between generators and retailers in a National Electricity Market (NEM), which encompasses New South Wales (NSW), Victoria, Queensland, South Australia (SA) and the Australian Capital Territory (ACT). Consumers meeting specified annual electricity consumption levels have been able to negotiate electricity-supply contracts with NEM-licensed retailers. Between 1995 and 1999 significantly lower electricity prices for consumers (than those available before deregulation) have been negotiated. Many Commonwealth agencies have taken advantage of them. In 1999, prices have been increasing but remain significantly less than pre-deregulated tariffs.

1.2 Although not included in the NEM, Western Australia (WA), Tasmania and the Northern Territory are pursuing their own electricity reforms. The Northern Territory announced its timetable in October 1999. Agencies are acting to negotiate agreements for better prices in these regions.

Reason for the audit

1.3 The ANAO conducted this audit because:

- the NEM presents savings opportunities through cheaper electricity prices from which most Commonwealth agencies should be able to benefit;
- the reduced emphasis on 'common user arrangements' (where procurement is centrally arranged) in Commonwealth purchasing makes agencies responsible for managing their electricity procurement;
- the devolution of responsibility for property management makes agencies responsible for managing their facilities. Coordinating the supply of, and payment for, electricity is an essential part of property management; and
- in the *Energy Efficiency in Commonwealth Operations* audit (Audit Report No.47 1998–99, tabled 15 June 1999), the ANAO identified that

significant savings were possible in the deregulated electricity market which could be used to fund energy-efficiency initiatives.

Audit objective and focus

1.4 The objective of this audit was to form an opinion on the adequacy of, and to identify best practice in, Commonwealth agencies' electricity procurement systems and procedures. In doing so, the ANAO also formed an opinion on the level and results of participation by Commonwealth agencies in the NEM. The audit concentrated on adherence by agencies to the principles of the *Commonwealth Procurement Guidelines: Core Policies and Principles (March 1998)* (the Guidelines), emphasising the importance of Commonwealth agencies achieving value-for-money (VFM) in their purchasing. VFM is one of the six principles on which the Guidelines are based. These are listed in paragraph 1.8.

1.5 The Guidelines are enabled by the Financial Management and Accountability Regulations (FMAR). Agencies subject to the Financial Management and Accountability (FMA) Act must have regard to these regulations in relation to the procurement of property or services. While not applicable to all Commonwealth bodies, the Guidelines provide a sound framework and useful guidance for procurement activity.

1.6 The objective and focus of the audit are consistent with the Joint Committee of Public Accounts and Audit Report No.369, *Australian Government Procurement*, June 1999, which:

- recommended that the ANAO increase the number of performance audits of the purchasing function; and
- suggested that chief executive officers ensure that the VFM principle is applied correctly.

Audit approach, criteria and methodology

1.7 A case-study approach was used for this audit; three studies were conducted.

1.8 The 'best Commonwealth procurement practice' criteria used to examine each case study were based on a check-list developed by the ANAO from the six principles on which the Guidelines are based. The six principles are:

- value-for-money;
- open and effective competition;
- ethics and fair dealing;
- accountability and reporting;

- national competitiveness and industry development; and
- support for other Commonwealth policies.

1.9 In each case study the chronological events, key participants, key documents and the results of examinations of electricity contracts were identified, documented and examined against the criteria.

Selection of case studies

1.10 Case studies were selected to include:

- the activities of large agencies with sites that were able to participate in the deregulated electricity market (these are termed ‘eligible sites’ in this report) in all the states participating in the NEM;
- smaller agencies with eligible sites, predominantly in the ACT; and
- a range of contracts and contracting situations, before and since deregulation began, which allowed examination of how contracts and procedures had developed.

1.11 The three case studies selected included a multi-agency electricity supply contract in the ACT; a recent Commonwealth Scientific and Industrial Research Organisation (CSIRO) electricity-supply contract; and five electricity-supply contracts negotiated by the Department of Defence (Defence). Details are as follows:

- the ACT electricity-supply contract (signed in September 1997) was arranged by the Energy and Environmental Services Unit (EESU) in the Domestic Property Operations Group of the Department of Finance and Administration (DOFA). This contract has 33 participating Commonwealth agencies and covers 79 sites in the ACT. It was negotiated before deregulation of the ACT market and accounts for about 10 per cent of the Commonwealth’s total electricity procurement. Most of the agencies involved in this contract are FMA agencies;
- the CSIRO contract was signed in September 1998. It includes all CSIRO’s eligible sites. CSIRO accounts for about 6 per cent of total Commonwealth electricity procurement. However, since the Guidelines are the Government’s statement of best procurement practice, CSIRO, as a significant purchaser of electricity, was included as a case study even though it is a CAC body; and
- the five Defence contracts include all the Department’s eligible sites. The most recent contract began in 1999. Defence procures about 45 per cent of the Commonwealth’s total electricity requirements; 80 per cent of this procurement occurs within the NEM. Defence is an FMA agency.

1.12 The case studies are summarised at Appendix 1. Findings from the case studies are discussed in Chapters 3 and 4.

The Australian Greenhouse Office

1.13 As noted above, the EESU arranged the electricity-supply contract for many Commonwealth agencies in the ACT. At the time, the EESU formed part of the Domestic Property Operations Group in DOFA.

1.14 The Government established the EESU to address energy conservation and procurement, including:

- investigating the opportunities for collaborative procurement and joint Commonwealth/State participation in the energy market;
- helping departments/agencies assess the possible financial and contractual risks of purchasing in a volatile market and to develop risk management and minimisation strategies; and
- providing an energy-procurement advisory service and representing the Commonwealth's broader interests in the deregulated energy market.

1.15 In the administrative changes after the October 1998 Federal Election, the Resources Division of the former Department of Primary Industries and Energy was transferred to the new Department of Industry, Science and Resources (DISR). DOFA's Energy and Environmental Services Unit was also moved to DISR in December 1998. In January 1999, the EESU transferred to the Australian Greenhouse Office (AGO).

1.16 Establishment of the AGO was announced in the Prime Minister's November 1997 greenhouse-gas statement. The AGO was delegated temporary authority to implement (among other things) several greenhouse-gas-related programs administered by other Commonwealth agencies. The EESU is now one of the programs delegated by DISR to the AGO. The EESU, however, moved physically from DOFA direct to the AGO and was never based in DISR. The EESU has since been renamed the Government Operations Team (GOT). The GOT has retained its whole-of-government energy management and procurement functions. Its activities are considered more fully in Chapter 4 and in Recommendation No.4.

Use of consultants

1.17 The operation of the NEM and the procurement of electricity involve a number of technical requirements, including understanding the structure and operation of the market; the technical requirements to be satisfied by participants; the knowledge needed for successful

procurement; and the preparation of contracts specific to electricity procurement.

1.18 To assist the ANAO evaluate the technical aspects of the Commonwealth's involvement in the deregulated electricity market, a technical expert was sought. Australian Tenant Advocates Pty. Ltd. was chosen because of its expertise in this field. Its contribution to the audit included:

- assisting to determine the audit criteria;
- designing and carrying out field work;
- analysing the electricity-procurement contracts;
- evaluating data; and
- drawing out findings and conclusions.

1.19 In working with the ANAO audit team, the contractor was authorised under the *Auditor-General Act*, and conducted its evaluation and analysis in accordance with ANAO Auditing Standards.

Conduct of the audit

1.20 The audit was conducted in accordance with ANAO's Auditing Standards between January and November 1999.

1.21 The audit cost \$195 000.

2. The National Electricity Market and the Level of Commonwealth Agency Participation

This Chapter provides an overview of the National Electricity Market and assesses the level of Commonwealth agency participation.

Introduction

2.1 Commonwealth agencies purchase of electricity, through contracts with electricity retailers, is enabled and regulated by the National Electricity Market, the systems and procedures of which provide opportunities to, and impose obligations on, participants.

2.2 This Chapter provides background information on the NEM so that the reader can better appreciate the discussion of the opportunities and obligations as they relate to Commonwealth agencies.

2.3 More detailed descriptions of the NEM are available from the Internet site www.nemmco.com.au, especially the paper titled *An Introduction to Australia's National Electricity Market*.

The nature of the National Electricity Market

2.4 The NEM is a wholesale market for the supply and purchase of electricity in NSW, Victoria, Queensland, SA and the ACT. Before it was established, various state and regional jurisdictional arrangements and controls restricted electricity consumers' choice of electricity supplier. The NEM now allows most non-household electricity consumers a choice of contracting with any electricity supplier in the NEM. Greater competition and lower prices have resulted. Remaining non-household and household electricity consumers are scheduled to be given the choice of supplier over the next few years, depending on location.

2.5 The information from the above mentioned Internet site indicates that Tasmania might join the NEM if an electricity connection with Victoria proceeds, and that it is unlikely that WA and the NT will be involved directly in the NEM because of the long transmission distances involved. However, Tasmania, WA and NT are pursuing their own electricity reforms.

2.6 Energy-consumption levels established by the Commonwealth, state and the ACT Governments determine the time at which an individual site belonging to a consumer can enter the NEM. The larger consumers were the first to enter the NEM. When consumption at a site reaches the pre-set level, that site is commonly called an *eligible site*. By December 1999, many Commonwealth sites will be eligible sites and can therefore enter contracts with electricity retailers. The precise number is unknown because of the lack of a relevant whole-of-government information.

2.7 By 2001 all electricity consumers (including all Commonwealth sites except in WA, Tasmania and the NT) are scheduled to enter the NEM. At this time all Commonwealth agencies will be able to choose their supplier(s) and enter supply contracts for all their sites located in the NEM states. Therefore agencies should understand the NEM and the procurement and contracting requirements appropriate to electricity procurement to take full advantage of the opportunities available (see Recommendation No.4, paragraph 4.68).

Development of the NEM

2.8 Before 1990, state and territory-owned authorities responsible for generation, transmission and distribution, dominated the electricity-supply industry. Electricity prices were set by government regulation to cover industry costs plus any returns required by governments as shareholders.

2.9 Work by the Industry Commission in 1991 showed that major increases in national productive output could be achieved by:

- restructuring the electricity-supply industry into the separate elements for generation, transmission, distribution and retail supply;
- introduction of competition into generation and retail supply; and
- enhancement and extension of the three state power systems, connected at present between NSW, Victoria and SA to include, eventually, Queensland and possibly Tasmania.

2.10 Deregulation began in 1991 with the creation of a National Grid Management Council, which established a protocol for the operation of the interconnected grid that formed the NEM. In 1997 the Australian Competition and Consumer Commission approved a National Electricity Code (the Code), under which the NEM operates. Deregulated retail operations commenced in 1995 under the above-mentioned protocol.

2.11 The Code is the peak compliance document in the NEM; all participants, including Commonwealth agencies, are required to comply with the Code's provisions. It provides a level of protection to participants

in the NEM regarding issues such as transmission and quality of supply and metering, billing and payment. Electricity-supply contracts, signed by Commonwealth agencies, must therefore comply with, and make appropriate references to, the Code.

2.12 Two new agencies were established to oversee the operation of the NEM:

- the National Electricity Market Management Company (NEMMCO), which operates and administers the electricity market in accordance with the Code; and
- the National Electricity Code Administrator (NECA), which administers the Code, as well as providing public information, resolving disputes and imposing penalties for non-compliance. It is also responsible for establishing power-system security and reliability standards.

Wholesale and retail operations in the NEM

2.13 Upon entering the NEM, Commonwealth agencies can choose between their original electricity suppliers (local retailers) and any other retailers licensed to operate in their state and territory market. Retailers compete not only on price but also on value adding such as:

- various contract provisions; for example, entry-exit provisions, by which agency sites become eligible or are no longer required by agencies; insurance arrangements; and indemnities;
- the quality and range of customer services; for example, specific billing arrangements, including discounts for early payment; reconciliations; hot-line services; and special monitoring and record-keeping; and
- energy-efficiency advice and management.

2.14 Retailers in the NEM buy wholesale electricity from generators and/or other wholesalers. All parties wishing to purchase wholesale electricity must register with NEMMCO as a Market Customer. Market Customers are required to meet prudential requirements to ensure payment for their electricity consumption.

2.15 Consumers are able to negotiate only in that area of the market related to the electricity price and value-added-services. These are called *contestable* charges. Other costs are regulated externally and may fluctuate; for example, network charges such as wires and poles; supply, demand and system-security charges. These are called *non-contestable* charges and cannot be avoided; nor can retailers set their prices.

Commonwealth agencies' participation in the NEM

2.16 In the course of the audit the ANAO sought to determine the general level of Commonwealth agency participation in the NEM and the resulting savings. The information obtained from the case-study agencies indicates that:

- Commonwealth agencies have participated in the NEM since it commenced in 1996 in Victoria;
- all portfolios with eligible sites have taken advantage of the opportunities made available by the NEM;
- in 1997–98 Commonwealth expenditure on electricity was about \$110–\$120 million, of which between \$60 and \$70 million is estimated to have been incurred at sites able to participate in the NEM. In this year savings of about \$11 million against pre-deregulation prices have occurred;
- not all Commonwealth agencies with eligible sites have participated in the NEM; the ANAO found that eligible sites existed in the ACT that had not negotiated contracts. Given the relatively high level of knowledge of energy management and therefore electricity procurement in the ACT, the ANAO considers it likely that there are still a number of eligible Commonwealth sites in NSW, Victoria and Queensland that have not been placed on supply contracts. Consequently, the most efficient and effective use of Commonwealth funds for electricity procurement is not occurring because of under-participation in the NEM; and
- some Commonwealth agencies are planning to enter the deregulated market in South Australia and are exploring opportunities to negotiate for the supply of electricity at reduced prices in the Western Australia and the Northern Territory.

2.17 Regarding the actual case studies:

- the case-study agencies (33 agencies in the ACT, CSIRO and Defence) are responsible for about 60 per cent of the Commonwealth's expenditure on electricity. Significant savings have resulted from the competition introduced by the NEM. The AGO advised that the range of savings obtained by all new participants in the NEM is between 4–50 per cent. The case-study agencies obtained savings from 20 to 40 per cent on previous electricity price levels; and
- in the ACT, at the beginning of the audit, 200 of 216 eligible sites (administered by 47 agencies) had contracts whose prices were better than they had obtained previously. By the end of the audit, 11 of the 16 remaining sites had established electricity-supply contracts.

Recommendation No.1

2.18 The ANAO recommends that all Commonwealth agencies with eligible sites, that are not participating in the National Electricity Market, take appropriate steps, where cost-effective, to do so.

2.19 In making this recommendation the ANAO notes that it might not be cost-effective in some cases to negotiate an electricity-supply contract because of, for example, a site's remote location.

Response:

AGO response: Agreed.

CSIRO response: Agreed.

Defence's response: Agreed.

DOFA response: Agreed.

3. Achieving Value-for-Money in Electricity Procurement

This Chapter summarises the case-study findings resulting from the examination of the value-for-money principle.

Introduction

3.1 The ANAO examined the electricity-procurement activities of the case-study agencies (DOFA, CSIRO and Defence) against a check-list (see Appendix 2) based on the Financial Management and Accountability Regulations (FMAR) and the Commonwealth Procurement Guidelines (the Guidelines).

3.2 The FMAR (Part 4—Commitments To Spend Public Money, see Appendix 3) require that Commonwealth officials engaged in procurement have regard to the Guidelines (or document the reasons for not following them) and that procurement approvals:

- be in accordance with the policies of the Commonwealth;
- make efficient and effective use of the public money; and
- be consistent with the terms under which the money is held by the Commonwealth.

3.3 The Guidelines identify and expand upon the following six core principles:

- value-for-money;
- open and effective competition;
- ethics and fair dealing;
- accountability and reporting;
- national competitiveness and industry development; and
- support for other Commonwealth policies.

3.4 It is important to note, that although FMA agencies must comply with the FMAR, they need only have regard to the Guidelines. The Guidelines state that agencies are able to decide how best to purchase, taking account of their own circumstances and the nature of the markets in which they are operating. In addition, the actual wording of the Guidelines allows considerable decision-making discretion.

3.5 The JCPAA Report found that this flexibility to arrange procurement systems and procedures provided by the relevant part of the FMAR (FMAR 8, see Appendix 3) had led to confusion (within Commonwealth agencies) regarding interpretation. In addition, the JCPAA found that no agency had indicated that the flexibility provided by FMAR 8 had improved procurement.

3.6 This Chapter deals with VFM. The Guidelines state “*Value-for-money is the essential test against which agencies must justify any procurement outcome*”. Chapter 4 considers the remaining five principles and compliance with the FMAR. Appendix 1 gives details of the results of the three case studies.

Value-for-money

3.7 For the value-for-money principle, seven key considerations were developed, with varying levels of detail. These are summarised in Appendix 2.

3.8 After examining the three case studies the ANAO considers that the case-study agencies achieved better value-for-money than they had before deregulation of the electricity market. The following summarises the evidence that supports this finding under the headings of:

- obtaining the best price and quality;
- maximising value-added-services;
- contract development;
- protecting the Commonwealth’s interests;
- the procurement process;
- contract management;
- continuous improvement; and
- the role of the Australian Greenhouse Office.

Obtaining the best price and quality

3.9 In the case studies, which included contracts negotiated between 1996 and 1998, prices were negotiated that were 20–40 per cent less than ‘general tariffs’ (ie. electricity prices available to sites ineligible for the NEM). Appendix 1, describing the case studies, provides more detail on these aspects.

3.10 All of the case-study agencies decided deliberately that ‘price’ would be the main criterion when selecting electricity retailers. The ANAO considers that this strategy was reasonable and justifiable given the circumstances that existed in the NEM when retailers were seeking to secure an adequate ‘market share’.

3.11 The subject of quality of electricity supply is a technical and complex subject that many consumers do not have to be concerned with. None of the contracts examined by the ANAO contained guarantees that the electricity retailers would maintain electricity supply. Retailers were generally indemnified against loss caused by power reductions and/or stoppages. On one hand, this does not give consumers a feeling of security but, on the other, the retailers are not in a position to guarantee electricity supply because, in the NEM, they have been separated from the generators and the networkers. It is the National Electricity Market Management Company's and the National Electricity Code Administrator's responsibility to take all reasonable steps to ensure electricity supply. Apart from this regulatory role, NEMMCO publishes quality/reliability statistics regarding the generators and networkers.

3.12 As a consequence, quality aspects of electricity supply are substantially out of the consumers' control. What is left to consumers is a management decision regarding risk; that is, by analysing NEMMCO's reliability statistics and the need for continuous supply, Commonwealth agencies will be in a position to decide whether 'back-up' generators are required.

Information for obtaining the best price

3.13 Information provided by the case-study agencies indicated that:

- in the light of several years experience in procuring electricity, there was information which they regarded as essential to obtaining the best price; and
- this information was directly related to the way electricity is priced in the NEM.

3.14 Examination of this pricing mechanism revealed that the cost of electricity has two major components—the non-contestable and the contestable. Non-contestable prices cover the cost of such elements as maintaining the network and are set by regulators. Contestable prices are variable and are determined in the following way:

- the generators supply NEMMCO with information on generating capacity, in different increments of generation by price;
- the retailers give NEMMCO information on how much electricity they wish to buy for their scheduled loads, in different increments of consumption by price;
- NEMMCO schedules electricity generators to meet the demand, usually beginning with the lowest-priced generator;

- this scheduling occurs at half-hourly intervals and is projected for a 'rolling' seven days; and
- the end price of electricity is calculated at five-minute intervals and is called the spot-price.

3.15 The volatility of this spot-price depends on the degree of fluctuation of demand.

3.16 Irrespective of the price arrangements made with an electricity retailer, the retailer generally is paying the spot-price. When a Commonwealth agency is negotiating a price, the retailer must have a good idea of what spot-prices it will be paying.

3.17 In this environment, it is clear that those with the best information will be in a much better position to reap the bigger rewards. For Commonwealth agencies, this largely means lower prices. From the case-studies and advice from the case-study agencies, essential information should include current prices and electricity requirements, and future electricity requirements and electricity demand-supply trends.

Recommendation No. 2

3.18 The ANAO recommends that all Commonwealth agencies should have systems and procedures to ensure that:

- (a) electricity-consumption patterns and future requirements are determined and revised at appropriate times; and
- (b) an appropriate level of knowledge of the National Electricity Market and a general understanding of its implications are available for negotiating electricity contracts.

Response:

AGO response: *Agreed.*

AGO commented that the benefits from understanding energy use are diverse and are encouraged. This enables agencies to take very specific actions to reduce their energy consumption, realise savings and accurately understand the payoffs from investing in energy-saving technology and energy efficient equipment and practices.

CSIRO response: *Agreed.*

Defence's response: *Agreed.*

DOFA response: *Agreed.*

3.19 The ANAO notes that:

- armed with this type of information and suitable analysis (including averages, peaks and planned changes), Commonwealth agencies can

provide prospective retailers with clear energy-use schedules that would result in greater certainty and lower prices;

- the extent to which this recommendation is implemented should be commensurate with the costs and benefits of doing so;
- the acquisition of electricity-consumption information is already required through the whole-of-government energy-use reporting requirement established by the Department of Industry, Science and Resources;
- there are numerous mechanisms by which this information can be acquired, including via an agency's present electricity supplier, in-house staff or consultants; and
- selecting an electricity retailer that has sound industry information and understanding is important to the process.

Electricity price trends and the implications regarding savings

3.20 In addition to examining the electricity prices achieved in contracts, the ANAO sought the views of the case-study agencies on the direction of market prices and expected ramifications on savings. The following summarises the information received:

- the market is expected to stabilise as retailers and generators adjust their operations in the light of market experience;
- a reduction in the number of retailers is expected;
- the significant price reductions experienced between 1996 and 1998 are unlikely to be available for future contracts. NSW prices have increased by 30 per cent since January 1998 and recent approaches to the market by major corporate buyers have seen prices offered 40–60 per cent higher than current prices;
- prices are expected, however, to remain below the pre-NEM general electricity prices in relative terms;
- additional savings could be available via:
 - increasing buying power by bulk-buying, thereby improving the Commonwealth's price negotiating position. This subject is considered in more detail under the heading *The Procurement Process*;
 - higher risk-taking in electricity purchasing. The case-study agencies all negotiated fixed-price contracts with scheduled reviews. An option open to agencies is to adopt a mixture of fixed and variable prices. The variable prices would depend on taking the best price on the spot market at selected times. The best price could be larger or smaller than the fixed price, so greater risk-taking and a good knowledge of the market would be required;

- negotiating value-added-services (VAS) which are considered next; and
- achieving greater efficiencies in electricity use, resulting in less electricity being consumed.

3.21 The subject of energy efficiency was addressed in the Auditor General's Audit Report No. 47 1998–99 *Energy Efficiency in Commonwealth Operations* and in the ANAO's Better Practice Guide titled *The Chief Executive Officer and Energy Efficiency in Commonwealth Operations* (released in June 1999).

Maximising value-added-services

3.22 Although the main criterion of the case-study agencies was price, all the contracts examined by the ANAO incorporated some provision of value-added-services by retailers, including:

- enhanced billing information and arrangements;
- entry and exit provisions when multiple agencies and sites were involved;
- price reviews to take advantage of wholesale-price reductions;
- energy-use information and analysis; and
- energy-efficiency/conservation examination and analysis.

3.23 Case-study evidence indicates that the value that was expected to be obtained when these contracts were negotiated has not eventuated:

- in the case of the contract negotiated by DOFA in the ACT (which now involves 25 Commonwealth agencies and 74 sites), the originally negotiated VASs either did not eventuate or were no longer required by DOFA shortly after the contract began. It was found that some of the negotiated VASs could not be supplied and others were of little or no use. From this experience, the contract manager advised that he would negotiate now a completely different set of VASs in new contracts based on the retailer's capabilities and a better knowledge of his needs as contract manager; and
- in the case of some of Defence's Victorian sites, the electricity retailer has yet to make adequate arrangements to supply information agreed under VAS clauses in contracts.

3.24 From these examples, and from advice provided by the case-study agencies, the ANAO concludes that these circumstances have been common in contracts negotiated by Commonwealth agencies in the NEM.

3.25 The list of possible VASs provided earlier, if required by an agency and if supplied at no additional cost by the electricity retailer, would result in better value-for-money. The challenge is how to obtain the VASs successfully. An indication of the benefits that can be obtained from more detailed information supplied by an electricity retailer is in the area of energy use. Analysis of such information can lead to the identification of periods of excessive electricity consumption (eg. after hours) and/or times of day at which electricity use could be adjusted to take advantage of price variations. In CSIRO, savings at one site alone were valued at \$71 000 from reductions in after-hours use and \$14 000 from moving consumption between price levels.

3.26 As mentioned earlier, as the electricity price increases, greater emphasis will be placed on VAS to maximise value-for-money. The ANAO considers that, when negotiating VAS, Commonwealth agencies should:

- have a sound knowledge and understanding of their own procurement and contract management operations, the cost of these operations and the related information requirements;
- know the capabilities of electricity retailers; and
- be aware that negotiating VAS as part of a contract can incur costs as well as achieving benefits.

3.27 One example of negotiating VAS is a 'meet-the-market' clause in a contract, which results in a sharing of savings should the wholesale price of electricity, paid by the retailer, fall below a set value. The set value of electricity is based on the negotiated fixed price. If the retailer is able to buy electricity at a lower price, the savings are shared between the retailer and the contracted consumer. Such clauses tend to have a price penalty in that the negotiated fixed price could be higher than would be the case if the 'meet-the-market' clause were not adopted. Another negative occurs if the price actually increases and the extra costs (rather than savings) are shared. One of the case-study agencies, in considering a 'meet-the-market' option, chose not to include the option because its assessment of future prices in the NEM indicated that there was a high risk that it would end up paying more by doing so.

Contract development

3.28 In the DOFA case study involving electricity supply in the ACT, the contract signed in 1997 was provided originally by the retailer. The ANAO considers that, at that time, the Commonwealth missed the opportunity to specify matters related to its interests such as billing and payment options, site-access arrangements and other provisions included in more recent contracts protecting the Commonwealth's interests.

However, the ANAO has noted that the most recent Commonwealth contract signed by Defence (August 1999) involves the same retailer used in the DOFA case study. This contract has been developed by the Commonwealth and includes a wide range of standard clauses intended to protect the Commonwealth's interests adequately.

3.29 The ANAO considers that the circumstances in the ACT market in 1997 influenced significantly the approach taken by all parties to the contract. These circumstances include:

- the DOFA contract preceded ACT deregulation and only the original ACT electricity supplier was in a position to offer a supply contract; and
- given that electricity is an essential utility that all parties to the contract had been receiving in the past from the same supplier, it was assumed generally that electricity supply would continue as before but at a lesser price.

3.30 Taking all the contracts examined, the ANAO found progressively fewer deficiencies and omissions over time in terms of inclusion of standard and special purpose clauses. Examples of such clauses include:

- specific account and billing procedures, including discount provisions for early payment of accounts;
- practical value-added-services;
- operational dispute-resolution systems and procedures;
- no-penalty termination arrangements;
- liability arrangements protecting the Commonwealth;
- practical supply-disruption systems and procedures; and
- no-penalty price-review schedules to allow the Commonwealth to benefit from reduced wholesale prices.

3.31 Another area of contract improvement has been the gradual removal of information about the rules and regulations of the National Electricity Market. The AGO advised that, in general, electricity-supply contracts do not have to detail all the obligations that the National Electricity Code imposes on the parties. The Code is readily available and, given that the above mentioned obligations are quite detailed and technical, they should only be referred to in contracts rather than quoted verbatim.

3.32 The most recent contracts, signed by CSIRO and Defence, are considered by the ANAO to be of a high standard. They have been developed to reflect agency priorities and, where practicable and

reasonable, clauses to protect the Commonwealth's interests have been negotiated with suppliers. The ANAO considers that these contracts, particularly Defence's, reflect current best practice.

Protecting the Commonwealth's interests

3.33 An important part of the VFM 'formula' is the level of protection of the Commonwealth's interests. What those interests are at any time is a value judgment and depends on the prevailing circumstances, but the ANAO considers that the following considerations are important:

- protecting the Commonwealth from unreasonable legal action, costs, delays and liability. This would include contract clauses addressing such topics as: guarantees, indemnity, insurance, confidentiality, privacy, terminations, dispute resolution, variations, access, security, severability and waivers;
- protecting and supporting other Government policies; eg. the energy, national competition and industry development policies;
- protecting the Commonwealth's intellectual property. This includes any useful information resulting from the establishment and implementation of an electricity supply contract. This is especially true of information that can be used in future market testing;
- guarding against conflicts of interest; and
- establishing systems and procedures that identify and ameliorate risks adequately.

3.34 The ANAO found that the earliest of the contracts examined did not protect the Commonwealth's interests as well as the more recent contracts. The main difference between the earlier and later contracts was the greater use of standard clauses in the latter. The same improvement in quality was evident in the procurement processes, that is, the procurement systems and procedures for the earlier procurements were less well-developed, in terms of formal structure, than the later ones. This greater level of formality results from a better understanding of the procurement process and has led to better preparation of tender documents, risk assessments and contract-management arrangements. These improvements reduce significantly the risks to Commonwealth interests.

The procurement process

3.35 Although it has found inadequacies in some parts of the procurement processes used by the case-study agencies, the ANAO considers that, in general, the processes examined have been effective

and efficient. Effectiveness is evidenced by the successful contracting for and supply of electricity. Efficiency is evidenced by significantly reduced electricity prices, the savings being greater than the cost of negotiating and managing the contracts.

3.36 Other considerations in the 'effectiveness and efficiency' equation include the characteristics of the teams involved in negotiating and managing the contracts (eg. skills of team members) and the actual procurement systems and procedures used.

Electricity procurement teams

3.37 In the CSIRO and Defence case studies, teams of two to four officers were involved in electricity procurement. The electricity procurement activities of these officers complement their primary responsibilities. These include property and facility management and energy efficiency/conservation management.

3.38 A differing situation exists in the ACT for the 25 agencies that have become party to the DOFA electricity-supply contract. Many of the smaller agencies did not have the specialised knowledge needed to achieve the best value-for-money and relied on DOFA's one- to two-officer team to negotiate a 'good' contract. Although the agencies involved in the contract had the responsibility (either directly or through a property manager) to communicate with the electricity supplier, this reliance has continued in the contract management. The original DOFA team is now the Government Operations Team (within the Australian Greenhouse Office) and remains the contract manager.

3.39 In all case studies, the teams made use of consultants to:

- prepare energy-use data reports for sites to be included in contracts, including financial modelling and sensitivity analysis;
- conduct NEM trends analysis;
- prepare tender documents;
- participate in contract negotiations;
- advise on energy-related matters, including peak and base electricity-use management, quality of supply, metering requirements and VAS;
- inform and advise site staff;
- conduct tender-proposal evaluations;
- assist tender evaluation boards in their preparations and in meetings with prospective suppliers; and
- undertake contract-management activities, including performance reviews.

3.40 All case-study agencies have advised that the contractors performed well and brought expertise that was not otherwise available to the procurement teams.

Procurement systems and procedures

3.41 The ANAO considers Defence's procurement systems and procedures to be the most formally developed and inclusive, especially in relation to the latest contract examined by the ANAO. Defence has developed a detailed *Defence Procurement Policy Manual* and a set of guidelines related to the procurement of consultancy services. The *Defence Procurement Policy Manual* recognises and builds on the Guidelines and other DOFA competitive contracting and tendering documents and includes numerous references to other sources of advice.

3.42 Clear evidence that these systems and procedures are being implemented was found in the Defence files examined by the ANAO, including evidence that:

- those responsible for administering the various sites involved in the proposed contracts had been kept informed and involved in preparations for the contract;
- either in-house expertise or consultants had been used for regular reviews and assessments of the NEM and agency requirements;
- standard contracts had been developed, assisted by legal opinions and knowledge gained from previous experiences, before tendering began;
- appropriate contract-process timetables had been developed and promulgated;
- requests for tenders had been advertised nationally;
- all known retailers had been approached individually;
- unsuccessful and short-listed applicants had been advised of their status and had been offered the opportunity to discuss the decision that had been taken;
- tender-evaluation boards had been appointed and appropriate records of meetings and decisions maintained;
- steps had been taken to develop a sound working relationship with successful tenderers in both contract negotiations and contract management;
- proposals for contract variations had been subject to legal review and opinion;

- some contracts had provisions for other Commonwealth agencies to join the contract and more recent contracts were including this provision as a matter of course; and
- provision existed for the regular supply of appropriately detailed consumption and billing information.

3.43 While this audit was being conducted, the ANAO noted that Defence had finalised another electricity-supply contract, beginning in August 1999. The entire process, including a comprehensive tendering procedure, took two months.

3.44 Although CSIRO has not established procurement guidance documents to a level similar to Defence's, examination of CSIRO's files indicates the same extent of procurement activity and documentation as found in Defence's files. Compared with the CSIRO and Defence 1998 procurement processes, the DOFA 1997 electricity procurement process was found to be poorly documented. The level of formal documentation was such that the ANAO was unable initially to form an opinion on whether appropriate systems and procedures had been used. Once an opinion could be reached, the ANAO concluded that the procurement system and procedure requirements of the Guidelines were generally followed by DOFA and adequate information exists from which procurement plans, decisions, actions and outcomes can be determined.

3.45 The ANAO considers that this situation of poor documentation occurred because of administrative circumstances at the time; ie:

- the property-management functions of the former Department of Administrative Services had moved only recently to the Department of Finance and Administrative Services;
- significant parts of the Commonwealth's property-management functions were being market-tested and outsourced; and
- numerous Commonwealth properties were in the process of being sold or being prepared for sale.

3.46 In this environment, the Government established an advisory group within DOFA to assist agencies with (among other things) their electricity procurement and energy management. At the same time (1997) the local ACT electricity supplier offered a pre-deregulation contract based on a significantly smaller price. Speed and price were deemed paramount and a contract was negotiated primarily by one Commonwealth officer with the help of a consultant. Significant savings were achieved but the level of documentation suffered.

3.47 The ANAO worked with DOFA and the AGO to establish the location of key documentation and was able eventually to find the contract negotiation and management trail and related documents. As a consequence, the ANAO is of the opinion that the procurement system and procedure requirements of the Guidelines were generally followed by DOFA and adequate information exists from which procurement plans, decisions, actions and outcomes can be determined.

3.48 Taking these findings related to 'procurement process' together, the ANAO considers that the use of formal procurement guidelines and check-lists in the procurement process reduces the risk that important activities are overlooked and that the Commonwealth's interests are inadequately protected. However, despite the existence of the Guidelines, a wide range of competitive tendering and contracting documents, ANAO Better Practice Guides and several Australian Standards dealing with contracts, none provides a comprehensive operational guide to procurement. The *Defence Procurement Policy Manual*, on the other hand, does lend itself to day-to-day operations. The ANAO considers that, by following the *Defence Procurement Policy Manual*, Defence staff and procurement delegates can be confident that reasonable steps have been taken to adhere to the six principles in the Commonwealth Procurement Guidelines. The ANAO suggests that other agencies might find Defence's manual useful.

3.49 While the use of Defence's manual is recommended, it should be noted that the document is a management aid and is no substitute for sound judgement.

Risk assessment

3.50 The ANAO considers that in procurement situations a formal, systematic and balanced approach should be taken to risk management. This includes managers making a formal decision concerning which areas warrant a risk assessment, and striking a balance between the costs of managing the risks and the benefits to be gained. In regard to procurement, the following specific areas of risk need to be considered:

- the buyer;
- the supplier;
- the contractual relationship;
- the external environment;
- identifying the need;
- selecting a procurement method;
- developing the specification and contract documents;

- seeking, clarifying and closing offers;
- identifying the preferred supplier; and
- evaluating offers.

3.51 Although the files examined in all case studies did indicate that some form of risk assessment occurred, there is no evidence that a formal judgement was made and a systematic approach was taken. Explicit consideration of risk was found in the DOFA files and in relation to the risk of the ACT electricity procurement exercise's being considered in breach of the National Competition Policy. CSIRO's files included evidence of a 'due-diligence check' in relation to selected suppliers. Defence's files do not mention specifically the conduct of a risk assessment but—and this applies equally to CSIRO and to a lesser extent to DOFA—the procurement systems and procedures in place incorporate considerations of risk.

3.52 The ANAO considers that a more structured approach to risk management is required in electricity procurement than was evident in the files of the case-study agencies. This may include (as used by CSIRO) a certification by a responsible procurement officer that appropriate risk assessment and associated risk mitigation occurred.

3.53 In regard to this issue, the ANAO draws Commonwealth agencies' attention to the useful information in:

- the *Defence Procurement Policy Manual*;
- *Before you sign on the dotted line ensure contracts can be managed*. MAB/MIAC Report No. 23, May 1997;
- *Selecting Suppliers—managing the risk*, ANAO Better Practice Guide, October 1998;
- *Guidelines for Managing Risk in the Australian Public Service*. MAB/MIAC Report No. 22, October 1996;
- *Managing risk in procurement—a handbook*, DOFA, 1996;
- *Risk Management Toolkit*. Competitive Tendering and Contracting Branch, DOFA, See www.ctc.gov.au/toolkits/riskmgt;
- *A basic introduction to managing risk using the Australian and New Zealand Risk Management Standard AS/NZS 4360:1999*. Standards Association of Australia HB 142-1999; and
- *Risk Management: AS/NZS 4360:1999*. Standards Association of Australia 1999.

Electricity procurement arrangements

3.54 A variety of alternative administrative arrangements for procuring electricity are possible; ie.:

- single-site agencies:
 - individual procurement and billing; eg. Parliament House;
 - outsourced procurement and separate billing; eg. the agencies that are party to the DOFA ACT contract, managed now by the AGO;
- agencies with multiple sites:
 - centralised procurement and billing arrangements; eg. Defence;
 - centralised procurement with decentralised billing; eg. CSIRO; and
 - various outsourcing options.

3.55 Outsourced procurement and/or billing includes becoming party to another contract arranged by a private-sector property manager or another agency like Defence, or a state government electricity-supply contract.

3.56 The larger (in terms of multiple sites and actual electricity use) of the Commonwealth agencies, from the CSIRO and Defence case studies, seem not to need any help in arranging bulk purchase of electricity. However, for small agencies, the costs of the entire procurement process can diminish if another agency's contract is adopted or collaborative buying can be arranged. From information obtained in the audit, the ANAO considers that there is significant scope for more of these types of electricity procurement.

Recommendation No.3

3.57 The ANAO recommends that:

- (a) larger Commonwealth agencies which unilaterally negotiate their own electricity supply contracts seek to negotiate a contract clause that allows other Commonwealth agencies to become party to the same contract and negotiated prices; and
- (b) smaller Commonwealth agencies, when entering the National Electricity Market, consider joining other Commonwealth agency contracts as a cost-efficient procurement option.

Response:

AGO response: *Agreed in principle.*

It is noted that, in practice, a premium is likely to be demanded by retailers for 'reserving' capacity. For this recommendation to be effective, large agencies would need to invite other agencies to join the contract. The AGO would be willing to facilitate such arrangements.

CSIRO response: Agreed.

Defence's response: Agreed.

DOFA response: Agreed.

3.58 While it would be expected that the larger the electricity-buying power the more leverage an agency would have in maximising VFM, the AGO advised that there are limits to this sort of leverage. The AGO cites the example of the DOFA ACT electricity supply contract and some of the Defence contracts, which have clauses that allow other agencies to become parties to the same contract and negotiated prices. In these cases the price does not reduce with the addition of another agency.

3.59 Collaborative procurement requires coordination between agencies. Evidence of coordination exists:

- in the Defence case study, in that a contract clause has been incorporated which allows other agencies to buy electricity from the same retailer at the same price and on the same terms and conditions as Defence. Small agencies and/or individual sites of multi-site agencies have taken advantage of this opportunity outside the ACT;
- in the activities of the Government Operations Team of the Australian Greenhouse Office. The ANAO found that the GOT provided a central source of knowledge and expertise in electricity procurement and energy matters generally at a level that would not otherwise be available to, or warranted in, most small agencies; and
- in the liaison occurring among several small agencies not part of the audit, but on separate contracts in the ACT. The ANAO was advised in the course of the audit that some of the smaller agencies in the ACT were considering forming collaborative buying blocks to take advantage of probable better prices because of the larger load that could be offered to the market. In addition, these agencies advised that they were well aware of the activities of the GOT but had chosen to remain independent.

3.60 From this evidence the ANAO considers that the significantly better VFM can be achieved by collaborative procurement, which will be maximised if there is better communication between, and coordination of, Commonwealth agencies. The ANAO also considers that the incentive to arrange collaborative contracts is not overly persuasive to many Commonwealth agencies, as the cost of electricity is not a significant proportion of total operating budgets. Also, as a significant part of electricity bills is not related to the price of electricity alone, the possible savings from collaborative procurement would be only a proportion of the total cost of electricity.

Contract management

3.61 Examination of the electricity contract management systems and procedures used in the three case-study agencies revealed that, although there is some room for improvement, the following best-practice features characterise the general approach being taken by the AGO (which replaced DOFA as contract manager), CSIRO and Defence:

- contract management is generally active; minor problems are not left to become major ones;
- communication with the electricity retailer occurs regularly;
- electricity-supply and related systems and procedures are reviewed regularly to identify and to mitigate risks;
- additional expertise, including legal, is sought when warranted;
- dealings are generally reasonable and fair, and
- contract variations are assessed rigorously.

3.62 Defence advised that, although a mixture of formal and informal arrangements existed in consumer-retailer liaison, a higher level of formality (such as specifying in contracts the frequency of meetings and raising agendas for meetings) might be appropriate.

Continuous improvement

3.63 There is convincing evidence indicating that, in all the case-study agencies, continuous improvement has occurred resulting in improvements in procurement efficiency and effectiveness. The officers involved in electricity procurement and contract management demonstrate, through their procurement management trails and resulting contracts, improved:

- analysis of agency electricity needs including base usage, peak usage and energy efficiency and conservation. In this area, Defence and CSIRO are using off-the-shelf computer software that facilitates the monitoring and billing procedures and the detailed analysis of energy use. This approach works best in conjunction with sophisticated networked electricity meters ('smart meters'), which provide information at short (for example, 30-minute) intervals. The resulting detailed knowledge of electricity requirements by individual sites was evident in the files examined;
- market knowledge. Knowing how the NEM works and price trends is crucial in analysing contract offers and options and this knowledge and its use in contract negotiations was evident in the files examined;
- sourcing and use of specialised advice; and
- negotiation skills, contracts and contract management.

The role of the Australian Greenhouse Office

3.64 As mentioned in Chapter 1, the Government established the EESU within DOFA to address energy conservation and procurement. The Government Operations Team (GOT) within the AGO is now responsible for these functions.

3.65 GOT electricity procurement activities were found to include:

- managing the DOFA electricity supply contract involving 33 agencies and 79 sites in the ACT;
- helping to identify agencies electricity needs and coordinating contract arrangements. In the course of the audit the ANAO became aware of 16 sites in the ACT which had yet to take advantage of the deregulated market. The GOT is contacting them about procurement options;
- assisting smaller agencies outside the ACT in joining the electricity contracts of large agencies; and
- promoting the incorporation of clauses in electricity supply contracts being negotiated by the larger Commonwealth agencies which allow other smaller agencies to join the contract.

3.66 From this standpoint, the ANAO considers that the whole-of-government activities of the Australian Greenhouse Office (through the Government Operations Team) have proved to be cost effective and have resulted in better value-for-money being achieved Commonwealth-agency wide in electricity procurement. The ANAO considers that the AGO has an important continuing role to play in support of Commonwealth-wide electricity procurement activities.

3.67 Considering the AGO's whole-of-government charter together with the findings in Chapters 2, 3 and 4, the ANAO considers that the AGO could:

- acquire and distribute National Electricity Market information relevant to participating Commonwealth agencies. As identified in earlier paragraphs, those with the best information (regarding their own electricity requirements, spot-prices and future trends) will be in a much better position to reap the most rewards. For Commonwealth agencies this means smaller prices. The agency specific information notwithstanding, the NEM information is common to all Commonwealth agencies, consequently it would be more efficient to have this information acquired and distributed centrally;
- maintain and distribute a list of Commonwealth agency electricity supply contracts which incorporate clauses allowing other agencies to take advantage of the same terms and conditions of electricity supply.

Under the earlier heading of ‘Electricity procurement arrangements’ (paras 3.54–56) the ANAO found that collaborative electricity procurement will be maximised if there is communication between and coordination of Commonwealth agencies; and

- develop an electricity supply contract best-practice-guide to help Commonwealth agencies in their drafting and negotiating of such contracts.

Recommendation No.4

3.68 The ANAO recommends that the Australian Greenhouse Office, through its Government Operations Team:

- (a) acquire and distribute National Electricity Market information relevant to participating Commonwealth agencies;
- (b) maintain and distribute a list of Commonwealth agency electricity supply contracts which incorporate clauses allowing other agencies to take advantage of the same terms and conditions of electricity supply;
- (c) negotiate further electricity supply contracts for small and medium size Commonwealth agencies as the opportunities arise and where the electricity contract terms and conditions of other Government agencies are not appropriate; and
- (d) develop a best practice guide for electricity supply contracts.

Response:

AGO’s response: *Agreed.*

The AGO is willing to, within it’s capacity, undertake the additional work. The AGO, DISR and CSIRO are jointly working to improve information flow for energy efficiency in Commonwealth operations.

3.69 In implementing the contract ‘best-practice-guide’ the ANAO suggests that the AGO:

- take into account Defence’s standard electricity supply contract, including requirements for VAS and clauses that:
 - enable participation by other agencies;
 - provide for retention by the Commonwealth of electricity-consumption information; and
 - provide for ANAO access to the relevant retailer’s records; and
- develop and recommend a standardised template for electricity billing information, which would help in comparing electricity use between sites and in agency compliance with DISR’s annual energy use reporting requirement.

3.70 The AGO advised that ownership of information can be a barrier to freely distributing energy data and that a separate contract may be required to access data, even with a retailer's consent. For example, NEMMCO licenses data forwarding agents to own data.

4. Observing the Other Commonwealth Procurement Guideline Principles

This Chapter summarises the case-study findings on the other five identified Commonwealth Procurement Guideline principles.

Introduction

4.1 A summary of the criteria used for examining the other Guideline principles is provided in Appendix 2.

4.2 After examining the three case studies the ANAO considers that the agencies involved:

- fulfilled their obligation to support open and effective competition;
- satisfied requirements for ethical behaviour and fair dealing in the tendering and contracting process;
- differed in the extent to which they conformed with accountability and reporting obligations in that one agency's procurement management trail was inadequate and two agencies did not comply with the reporting requirements of the Guidelines. These requirements require that all procurements exceeding \$2000 in value be gazetted by using the Telstra Transigo electronic reporting system; and
- generally met national competitiveness and industry-development obligations by participating in the NEM.

4.3 The remainder of this Chapter provides the evidence supporting these findings.

Open and effective competition

4.4 The three case studies can be divided into two categories regarding the open and effective competition principle. The CSIRO and Defence case studies involved considering all retailers operating in the NEM. DOFA's case study involved a pre-NEM contract and involved only one retailer.

CSIRO and Defence

4.5 Retailers were given reasonable access to the procurement opportunity and CSIRO and Defence actually encouraged competition by approaching all known retailers in the NEM.

4.6 CSIRO and Defence ensured that their procurement systems and procedures were open and transparent by:

- being consistent; that is, all NEM retailers were treated similarly;
- providing adequate and timely access to information, including:
 - site energy-use data;
 - details of how information in response to the request for tender was to be presented by the supplier;
 - questionnaires identifying a variety of assessment criteria, including the agencies' application of other Commonwealth policies such as those related to occupational health and safety and equal opportunity;
 - request-for-tender conditions and related evaluation details;
 - how tender evaluation boards would function; and
 - a copy of the proposed contract with the Commonwealth;
- appropriately broad advertising;
- using only the selection criteria that tenderers had been advised would be used; and
- offering bidders a written or oral briefing on why their offers had been successful or failed.

DOFA

4.7 The DOFA procurement case study involved only one retailer operating in the ACT. It occurred several months before the deregulation of the ACT electricity market, when the retailer was the only organisation permitted to negotiate an electricity-supply contract. In this regard, the contract negotiation process completed by DOFA was anticipating the deregulation of the ACT electricity market and therefore could not benefit from previous experience. With only one retailer permitted to negotiate electricity supply in the ACT there was no requirement for DOFA to conduct a comprehensive tendering process. The ANAO considers that, in the circumstances, DOFA achieved significantly better value-for-money than had been achieved before.

4.8 In the initial stages of the contract negotiations (July–August 1997) DOFA was negotiating a supply contract for the properties it managed. As it became clear that other government initiatives would result in a significant number of these properties being sold in the contract's expected currency period, DOFA's role broadened to include representing agencies which had been DOFA's property clients and other Commonwealth agencies in the ACT. It is clear from the files that the agencies that eventually became party to the contract had left the matter essentially in DOFA's hands.

4.9 There is no evidence in the files that DOFA, knowing that deregulation would see other retailers enter the ACT market, had taken steps to ascertain what these retailers might offer. DOFA advised that the general direction of prices had been assessed from market intelligence obtained from Victoria's earlier deregulation.

4.10 In addition, there is no evidence that the agencies that had been expected to become party to the contract had been advised of the consequences of entering contracts before deregulation. However, although these agencies effectively delegated responsibility for negotiating a 'good' contract, it remains their responsibility to ensure that the Commonwealth Procurement Guidelines applying at the time were adhered to.

Ethics and fair dealing

4.11 The ANAO found that the case-study agencies satisfied the requirements for ethical behaviour and fair dealing in the tendering and contracting process. Specifically the files examined indicated that:

- retailers were dealt with equitably;
- commercially sensitive information was kept secure;
- care was taken in the scrupulous use of public moneys; and
- the various responsibilities and authorisations in procurement were separated.

4.12 In addition, the ANAO found no evidence that:

- conflicts of interests existed; or that
- procurement staff used their positions to benefit themselves or others by way of gifts, hospitality or other benefits.

Accountability and reporting

Management trail

4.13 Management trails were found to exist dealing with procurement plans, decision making and associated activities. In particular, records were identified that covered matters such as:

- communications with suppliers or tenderers;
- the selection criteria on which evaluation and selection decisions were based;
- details of how bids were clarified during evaluations;
- agreements reached with suppliers during negotiations;
- details of debriefings for suppliers;

- records of contractors' performance; and
- billing and account-payment activities confirming that reduced prices were in effect.

4.14 The accessibility and completeness of CSIRO and Defence's records were sound. DOFA's files were spread over a number of locations, including the consultant's office and the personal files of officers. This situation was substantially remedied during the course of the audit.

4.15 The ANAO considers that the rigour that formally documenting the management trail imposes on the decision-making process is important in mitigating the risk to the Commonwealth's interests. Informed judgment is required when deciding to what extent documentation should occur.

Delegations and responsibilities

4.16 The major agencies examined have adhered to appropriate delegations and responsibilities. The ANAO found that agencies' senior staff were involved in the required approvals and that appropriate briefings were provided. As a general observation, the files indicate that, in the more recent contracts, procurement has become routine and less briefing of senior staff has been required. Nevertheless, the ANAO found that appropriate delegations were being exercised and that appropriate senior staff were being kept informed.

Reporting

4.17 The ANAO found that there had been a varied response to gazetting intended procurements and the letting of contracts by using the Telstra Transigo electronic system as required by the Guidelines for all procurements over \$2000. It was evident that the responsible staff in some agencies did not understand, or necessarily know of, this requirement. For example, one agency suggested that to report in this way would breach the commercial-in-confidence provisions of contracts. As the Transigo report identifies only the total estimated liability of a contract the ANAO does not accept this as a valid reason for not gazetting electricity procurement contracts.

4.18 The ANAO notes that the JCPAA Report found that there did not appear to be appropriate measures of accountability and performance assessment consistent with CEO's procurement responsibilities. Also, that the current state of Commonwealth agency reporting of purchasing activities was not acceptable.

Support for other Commonwealth policies

4.19 The Guidelines state that agencies and their officers have an obligation to be aware of relevant government policy and to reflect its requirements in the way they do business. The Guidelines identify numerous Commonwealth Government policy areas that might, depending on the circumstances, be considered. The ANAO considers that the following policy areas are directly related to the procurement of electricity:

- national competitiveness and industry-development policies. The case-study agencies generally met the National Competition Policy and industry-development obligations by participating in the National Electricity Market;
- procurement policy. The case-study agencies had procurement systems and procedures that were generally consistent with the majority of the Commonwealth Procurement Guidelines;
- the energy policy. Energy efficiency and conservation issues have been addressed by the case-study agencies;
- greenhouse gas emission targets and the National Greenhouse Strategy 1998. Greenhouse issues had been considered by some agencies, although they did not seem to have been addressed in depth. For example, until the most recent (August 1999) Defence contract in the ACT, provision had not been made in contracts for electricity procurement from 'green' generators. The ANAO acknowledges that at present a premium would have to be paid for such electricity, but has also noted that in September 1999 the AGO Government Operations Team coordinated an exercise 'Investing in Green Energy' where 11 agencies have undertaken to include 'green' energy in their procurements; and
- policies to ensure the preservation of the environment and the national estate. Environmental matters had been considered in a similar fashion to greenhouse issues. For example, in one of the case studies tenderers had been asked whether they belonged to the Greenhouse Challenge (an Australian Greenhouse Office greenhouse gas initiative) and whether they had an environmental policy, but the response had not affected subsequent activities.

4.20 Other policy areas identified by the Guidelines include workplace relations, advancement of the interests of Aboriginal and Torres Strait Islander people, equal-opportunity and affirmative action. Some case-study request-for-tender documents had required tenderers to comply with the Government's equal-opportunity legislation and attention had

been drawn to legislation concerning Aboriginal and Torres Strait Islander employment. However, these provisions had not necessarily been carried through to the over-all electricity procurement process, although in some case-study agencies they had been a factor included in tender evaluation board considerations.

Compliance with the FMAR

4.21 The FMAR (Part 4–Commitments To Spend Public Money, see Appendix 3) require that Commonwealth officials engaged in procurement have regard to the Guidelines (or document the reasons for not following them) and that procurement approvals:

- be in accordance with the policies of the Commonwealth;
- make efficient and effective use of the public money; and
- if the proposal is one to spend special public money, be consistent with the terms under which the money is held by the Commonwealth.

4.22 Taking all of the preceding into account, the ANAO considers that the FMA case-study agencies:

- largely complied with the Financial Management and Accountability Regulations; and
- had procurement systems and procedures that were generally consistent with the majority of the Guidelines.

4.23 The above findings notwithstanding, the ANAO found no indications in any of the case-study files that the case-study agencies had made use of the Guidelines. The indications are that the case-study agencies rely far more on procurement officer knowledge, experience and judgement and internal procurement guides and instructions than on the Commonwealth Procurement Guidelines.



Canberra ACT
5 January 2000

P. J. Barrett
Auditor-General

Appendices

Appendix 1

Case studies

Selection of agencies

Case studies were selected that identified:

- the activities of large agencies with sites that were eligible to participate in the deregulated electricity market in all states participating in the NEM. The two large agencies selected account for about 50 per cent of the Commonwealth's electricity consumption;
- how the requirements of smaller agencies that had eligible sites, predominantly in the ACT, had been addressed. This study was of a contract covering 33 Commonwealth agencies (79 sites) in the ACT accounting for about 10 per cent of total Commonwealth electricity consumption; and
- a range of contracts and contracting situations since deregulation began, including some in which agencies had separate contracts with the same supplier.

The three case studies selected involved a multi-agency contract in the ACT, a CSIRO contract and five contracts negotiated by the Defence. Details of these studies are as follows:

- the ACT contract (signed in September 1997) was arranged by the Energy and Environmental Services Unit of the Domestic Property Operations Group of the Department of Finance and Administration. This contract has 33 participating Commonwealth agencies and covers 79 sites in the ACT. It was negotiated before deregulation of the ACT market and accounts for about 10 per cent of the Commonwealth's total electricity procurement;
- the CSIRO contract (signed in September 1998), covers all CSIRO's eligible sites. CSIRO accounts for about six per cent of total Commonwealth electricity procurement; and
- the five Defence contracts (signed at different times) cover all the Department's eligible sites. The most recent contract began in 1999. Defence procures about 45 per cent of the Commonwealth's total electricity requirements. Of this, 80 per cent occurs in the NEM.

Case study 1

Across-agency purchase of electricity in the ACT

Reasons for selecting electricity purchasing in the ACT for a case study

This 1997 contract was selected because:

- it illustrates features of common-user/collaborative buying arrangements;
- it applies to the largest single grouping of eligible sites on electricity-supply contracts in the ACT, and covers 36 per cent of Commonwealth sites that met the criteria for entering the NEM at that time; and
- it was coordinated by the then Energy and Environmental Services Unit in DOFA and this Unit's successor, the Government Operations Team in the Australian Greenhouse Office, is the contract manager. The whole-of-government electricity procurement activities of the GOT are of particular interest.

Overview

In September 1997 a contract was arranged by the then Energy and Environmental Services Unit in DOFA for supply of electricity to various Department of Administrative Services administered Commonwealth properties in the ACT. It was extended later to include other Commonwealth sites, eventually 79 sites of 33 agencies. It was arranged before deregulation of the ACT electricity market. It included back-dating provisions that provided a price advantage for some sites up to 12 months before they would become eligible sites in the deregulated market. (See Table A).

Table A
Price advantage of sites included in the 1997 DOFA contract

Number of Sites	Date when new contract price started A	Month the sites became eligible to enter the NEM B	Price Advantage (Months) (a) (A–B)
15	01-Jul-97	3/98	8
25	01-Jul-97	5/98	10
1	01-Jul-97	6/98	11
10	01-Jul-97	7/98	12
1	11-Dec-97	5/98	6
1	07-Apr-98	5/98	1
2	07-Apr-98	6/98	2
4	14-May-98	6/98	1
1	14-May-98	7/98	2

Note: (a) *Price advantage* means the difference between the existing pre-deregulation prices and the more favourable prices negotiated within the contract prior to deregulation.

Estimated savings on previous electricity prices for individual sites ranged from 28 to 43 per cent—about \$7 million a year—over the three years of the contract. Before the contract the total cost of electricity for the sites placed on contract was estimated at about \$12.5 million a year or about 10 per cent of the total Commonwealth electricity cost.

After deregulation, and after the contract had been in operation for 12 months, the supplier approached DOFA with a revised price offer, which depended on the contract being extended by 12 months. It was accepted by DOFA. The additional savings from this extension were estimated to be about \$1.1 million over the life of the contract.

The AGO has assessed that under the original contract provisions the total savings achievement is 24.5 per cent. Actual savings achieved in years 1 and 2 of the contract have been \$0.818 million and \$1.1 million. These are indicative figures only. Accurate assessments cannot be made because of such factors as the sale of sites, which at the time of the contract were controlled by the then Department of Administrative Services, refurbishing of buildings and the adoption by agencies of more energy-efficient practices. In most cases the sold properties remained on the contract.

Other Commonwealth agencies in the ACT

Although the following is outside the immediate scope of the case study, the ANAO found that 32 Commonwealth agencies had negotiated separate contracts covering another 126 sites in the ACT. Of these, 82 sites had been placed on contracts with DOFA's electricity retailer before deregulation. Post-deregulation, 44 sites had been placed on contracts with other retailers.

Application of the Commonwealth Procurement Guidelines

Price and quality

The Commonwealth obtained significantly better electricity prices for agencies than those being paid before the contract. The initial assessment before signing the contract suggested that an over-all advantage of about 14 per cent, or \$4.2 million over the initial three years life of the contract, would be created without waiting for deregulation. More recent estimates improve on this saving.

The electricity retailer would not guarantee continuity of electricity supply and included a clause in the contract confirming this. The AGO advised that, because in the NEM the electricity retailer is separate from the generators and those responsible for the delivery network, retailers are not in a position to guarantee either quality or continuity. The AGO further advised that it was NEMMCO's responsibility to ensure continuity of supply. The implication is that Commonwealth agencies have to assess the risk to their operations and make arrangements to ameliorate areas of unacceptable risk; eg. by installing back-up generators. In addition the National Electricity Code has provisions dealing with the quality of supply, with which all participants in the NEM must comply. Therefore, compliance with the Code should be acknowledged in contracts.

Value-added-services

VASs were negotiated in the contract. A financial 'value' was not placed on them.

The supplier-initiated VASs were at no additional cost. However, they have not generally been provided. The files show that efforts to obtain some of the VASs have had little result. DOFA advised the ANAO that, upon reflection, their practical value was now considered minimal. The VASs to be provided included:

- nominating a designated account manager to provide a single point of empowered contact between the supplier and DOFA;

- conducting quarterly reviews and reports including reliability of supply, comparative energy consumption and energy management opportunities;
- price reviews; and
- contributing supplier expertise relating to greenhouse targets and energy costs.

Procurement processes

DOFA advised that lessons learnt from deregulation of the Victorian electricity market in 1994 were significant in assessing the ACT contract outcome.

Negotiation of the contract and subsequent activities in its extension and administration occurred at low cost in staff (one to two officers) and other resources, and achieved significant reductions in costs for a number of agencies and dealt simultaneously with a wide range of energy matters affecting Commonwealth agencies. The initial contract process was relatively quick (about a month) as tendering was not required, and negotiations occurred immediately with the only eligible supplier.

The DOFA electricity procurement process was found to be inadequately documented. The level of formal documentation was such that the ANAO was unable initially to form an opinion on whether appropriate systems and procedures had been used. The ANAO considers that this situation occurred because of administrative circumstances at the time, for example:

- the property-management functions of the former Department of Administrative Services had moved only recently to the Department of Finance and Administrative Services;
- significant parts of the Commonwealth's property-management functions were being market-tested and outsourced; and
- the ramifications of the Commonwealth Property Principles were being felt through the sale of numerous Commonwealth properties.

In this environment, the Government established an advisory group within DOFA to help agencies with (among other things) their electricity procurement and energy management. At the same time (1997) the local ACT electricity supplier offered a pre-deregulation contract based on a significantly smaller price. Speed and price were deemed paramount and a contract was negotiated primarily by one Commonwealth officer with the help of a consultant. Significant savings were achieved but the level of documentation was less than warranted.

The ANAO extended its search for DOFA documentation and was able eventually to find the contract negotiation and management trail and

related documents. As a consequence, the ANAO is of the opinion that the procurement system and procedure requirements of the Guidelines were generally followed by DOFA, and adequate information exists from which relevant procurement plans, decisions, actions and outcomes can be determined.

In the course of the audit the AGO was liaising with the managers of 16 eligible sites that had not, at the time, entered into an electricity-supply contract.

Contract development

The supplier provided the draft contract, not the Commonwealth. The evidence suggests that negotiation of details was limited and that the supplier's draft was accepted with few alterations. The ANAO considers that opportunities to include such matters as contract duration, and other pricing, billing and payment options were missed. Deficiencies in the initial contract were not resolved when the contract was extended on 3 November 1998.

DOFA sought legal advice on the draft contract and several adjustments were made. Despite this advice, the ANAO considers that there were deficiencies in the contract resulting in the Commonwealth's interests not being as well protected as they could have been. For example, the contract:

- does not deal with intellectual-property matters as they affect the Commonwealth, insurance matters and arrangements for monitoring and inspections;
- liability coverage is confined to the supplier's interests;
- the access to and planned interruptions of supply, and maintenance arrangements, would benefit from greater detail; and
- there is no clause permitting ANAO or DOFA access to the retailer's records.

A consultant conducted the analysis of the offer. The consultant:

- compared the prices offered with those expected to be offered by other retailers when deregulation occurred in the ACT;
- prepared an energy-use profile report for the DOFA-managed properties (the original properties to be included in the contract); and
- identified DOFA risks associated with accepting the retailer's offer; including:
 - the fact that many of the DOFA-managed properties would be sold in the foreshadowed life of the contract and arrangements would

have to be made to protect prices being received by the tenant Commonwealth agencies; and

- that the contract might be seen to be bypassing the NEM's intended market testing for electricity supply.

The AGO has advised that:

- it considered the contract appropriate for electricity procurement purposes; and
- the tendency to include unnecessary detail in electricity supply contracts dealing with NEM rules and regulations and every possible risk should be avoided. Contracts need to be working documents of manageable proportions and simplicity.

The ANAO considers that, in part, the contract deficiencies might be the result of inexperience in dealing with the deregulated market given that DOFA was negotiating one of the first ACT electricity supply contracts which anticipated the deregulation of the ACT electricity market. The ANAO has noted that, in the other case-study agencies, as experience of the deregulated electricity market has developed, the standard of contracts and the performance of retailers and advisers (legal and others) have improved. A new contract has yet to be negotiated for the agencies involved in the DOFA contract, but the ANAO would expect the procurement processes and the resulting contract to show a similar level of improvement. The ANAO noted also that agencies were now providing a Commonwealth contract as a basis for negotiations when requests for quotations/tender are issued.

Contract management

The ANAO's examination of contract-management matters provided varied results, for example:

- contract-management arrangements were not defined specifically in the contract. However, the actual contract management by the AGO was found to be active but generally informal. The files show that the AGO communicated regularly with the retailer and the agencies that were party to the contract, but there were no formal mechanisms establishing contract meetings or agendas;
- the contract contains protocols for dispute resolution;
- the files show that the consultant (on behalf of the AGO) was involved in contacts between the supplier and agencies;
- although there is little evidence in the files that the agencies participating in the contract were informed adequately of the details and ramifications of the contract, the AGO advised that this had occurred informally;

- most of the negotiated VASs have not been provided by the supplier. Follow-up has occurred but there is no list of minimum specifications in the contract against which the supplier's performance could be assessed. The AGO advised that the retailers' administrative systems and procedures had not proved capable of providing the detailed reports that the AGO was expecting to receive, and in hindsight, most of the VASs included in the contract were now considered not required; and
- the contract contains no clauses dealing with prevention and penalty systems and procedures for non/under-performance by the supplier.

Common user arrangements and collaborative procurement

Examination of GOT's files shows that GOT has approached agencies in the ACT which have eligible sites, that have not yet become part of an electricity supply contract, suggesting that they join the DOFA contract. This process included GOT applying to the supplier on the behalf of an agency to join the contract, and then providing the agency with a standard contract for review and authorisation.

In the course of the audit the ANAO was advised that there remained 16 eligible sites in the ACT that were not participating in the NEM (via an electricity contract) and which were therefore paying an unnecessary premium for their electricity. The AGO has since liaised with those agencies and 11 of these sites are now (at the time of printing this report) on contract.

Open and effective competition

Only one supplier was legally available in the ACT at the time the DOFA contract was signed (September 1997, the new electricity prices to apply from 1 July 1997). Deregulation did not begin until December 1997.

Ethics and fair dealing

There is no evidence to suggest that the staff of DOFA, other Commonwealth agencies or the consultant behaved unethically or unfairly.

Accountability and reporting

Examination of the files shows that:

- senior DOFA staff were involved in the approval of the initial contract negotiations and signing the initial contract. The extension of the contract received similar approval. The expected savings were announced in a ministerial press release;
- most participating agencies left the contract matters entirely in DOFA's hands. A requirement of the contract is that a 'Schedule 2' document

be signed when agencies agree that DOFA can negotiate and sign the contract on their behalf. ANAO did not identify a formal register of Schedule 2 documents at DOFA, but was advised that the retailer had a full set. The consultant held an informal record of Schedule 2's. Thus these records were in non-Commonwealth hands; this situation was remedied in the course of the audit. The ANAO noted that agencies with sites outside the Domestic Property Operations Group-controlled buildings had completed appropriate Schedule 2's; and

- DOFA made arrangements with agencies for recording and reporting electricity-supply matters for the purposes of contract management.

National competitiveness and industry development

The introduction of competition via market-testing of electricity supply is the primary reason for establishing the NEM. Although the DOFA contract was at the time permissible, the acceptance and signing of the contract offered in the ACT to DOFA and other participating agencies effectively prevented market testing. DOFA could have waited until market testing was possible. Taking this course would have cost, at the least, the savings resulting from signing earlier.

As mentioned earlier, at the time the electricity supply contract was signed, only one electricity retailer was legally able to enter into a contract in the ACT. Because of the timing and provisions of the contract, the opportunity for market testing by the agencies party to the contract could not occur until three years after deregulation of the ACT market. The files show that DOFA was aware that there was a risk of criticism about this situation if the contract was signed.

Examination of the files did not reveal any evidence that DOFA made any approaches to electricity retailers, which were expected to operate in the ACT in late 1997. Equally, the ANAO found no evidence to suggest that other retailers had objected to the contract.

As mentioned earlier, the electricity retailer offered an option to those party to the contract to accept a cheaper price while extending the contract an additional year. The AGO advised the ANAO that:

- although the opportunity was not taken to test the market at that time, analysis of the NEM prices indicated that the cheaper price offered under the option was competitive;
- the new price, plus the savings achieved by having cheaper prices before deregulation, produced total savings that were considered the best VFM available; and
- other agencies seek to become party to the revised DOFA contract because they consider the new price to be VFM.

Support for other Commonwealth policies

There are a wide range of Commonwealth policies which can be supported by agencies through their procurement processes. The DOFA files indicate that the following subjects were considered in relation to the contract:

- anti-competition legislation;
- common-user arrangements; and
- the National Electricity Code.

Conclusions

In summary:

- the DOFA contract has achieved significant reductions in electricity costs for agencies;
- although no specific references to the Commonwealth Procurement Guidelines were found in DOFA's files indicating that formal use was made of the Guidelines, the records do indicate that there was general consistency with the six Guideline principles;
- a consultant was used to supplement DOFA staff and to advise on and review matters related to development of the contract and its extension;
- a full procurement process that included requests for quotations/tenders was not followed because only one supplier was legally available;
- the contract was provided by the supplier and is less detailed than those in use now in other agencies, but is comparable to other contracts raised in other agencies at about the same time;
- the management trail established by the then EESU was poor; although this situation has since been substantially remedied;
- VASs were included in the contract, but have either not been provided or have not been required by the contract managers;
- the values placed on each VAS are not easily comparable as financial values;
- the EESU (now GOT) and the consultant have implemented a satisfactory level of contract management; and
- the GOT continues to implement its whole-of-government electricity-procurement advocacy function.

Case study 2

The Commonwealth Scientific and Industrial Research Organisation

Reasons for selecting CSIRO for a case study

CSIRO was selected for a case study because:

- it is a significant consumer of electricity, consuming about 100 giga watt hours nationally (six per cent of total Commonwealth consumption), of which 33 giga watt hours is in the ACT;
- its experience would illustrate the nature of contracts required and the level of savings possible, having been involved in negotiating contracts for the supply of electricity since deregulation began in Victoria in 1995; and
- it is a decentralised organisation with divisions in all of the states in which the NEM is in operation. In December 1998, it entered a whole-of-agency contract for electricity supply in NSW, Victoria and the ACT. This contract allows consideration of any benefits/disadvantages of negotiating agency-wide, or multiple-agency (common user arrangement and collaborative procurement) contracts for the supply of electricity.

CSIRO overview

CSIRO's Energy Management Unit (EMU) conducted electricity procurement on behalf of all CSIRO Divisions. Although the EMU does so and manages CSIRO's electricity consumption, bill monitoring and checking and energy management, individual CSIRO divisions retain ultimate responsibility for these activities.

The EMU has two full-time staff and one part-time. The annual salary and operating budget is about \$300 000 (for 1997–1998). The EMU's main function is to monitor energy consumption by CSIRO, to advise and help its divisions with their energy-management programs and to negotiate electricity prices and other energy prices. It also coordinates the Commonwealth's energy-use annual reporting requirement.

CSIRO has negotiated electricity-supply contracts as follows:

- *1996 to 1998, Victoria:* In June 1997 CSIRO estimated that annual savings under this contract were \$500 000;
- *1997 to 1998, NSW:* In June 1997, CSIRO estimated that the annual savings under this contract were \$1.38 million for the 15-month life of the contract, representing a 45 per cent reduction in the cost of electricity to CSIRO sites in NSW;

- *July to September 1998, ACT:* An interim contract until a whole-of-CSIRO contract could be negotiated; and
- *September 1998, combined NSW, Victoria and ACT:* On the completion of the existing contracts in NSW, Victoria and the ACT, a combined whole-of-CSIRO contract was signed. The approximate value of the contract is \$6.25 million a year, representing savings of about \$2 million a year—a 20 per cent saving on pre-NEM electricity prices for an equivalent amount of electricity. This contract includes 61 separate accounts.

Application of the Commonwealth Procurement Guidelines

CSIRO, as a significant purchaser of electricity, was included as a case study even though it is a CAC body. The ANAO notes that the Guidelines do not apply to CAC bodies unless the agency or a Minister requires their application. However, as the Guidelines are the Government's statement of best procurement practice the ANAO considered it appropriate to use them as the basis for consideration of the electricity procurement activities of CSIRO.

Price and quality

The contract was determined on price with a better price being achieved than before. There were only marginal price variations between the best offers received from the 14 retailers which responded to CSIRO's request-for-tender.

The retailer would not guarantee continuity of supply and included a clause in the contract confirming this.

Value-added-services

CSIRO acknowledges that VFM might include more than price alone, but did not consider that other factors existed at the time which would have added value to the contract. However, the ANAO considers that VASs have been gained from the contract. The EMU has advanced energy-management procedures that use information from the sophisticated electricity metering specified in the contract. Systems and procedures are in place to use this information and to review billing practices. Although the CSIRO appeared to consider such information a standard requirement in electricity procurement, other agencies considered it part of VAS arrangements.

Procurement process

Examination of CSIRO's procurement process reveals that it was generally effective and efficient. Effectiveness is evidenced by the securing of

electricity supply. Efficiency is evidenced by comparing the savings with the cost of arranging and managing the contract. The EMU, which costs the CSIRO \$300 000 a year (for 1997–98), negotiated a contract estimated to save about \$2 million a year, and did so while attending to its other energy-management tasks.

In addition the ANAO found that:

- the CSIRO had a detailed knowledge of its electricity requirements for individual sites before negotiations began;
- those responsible for procurement had detailed knowledge of the NEM and experience in negotiating contracts in the NEM;
- a standard draft contract had been developed and was given to prospective suppliers as part of the request-for-tender process, to form the basis of contract negotiations;
- CSIRO has established its own internal procurement instructions, which include requirements for risk and due-diligence assessments of prospective suppliers. These requirements were complied with in the contract-evaluation process. The EMU adhered to CSIRO's procurement instructions; and
- the procurement process was consistent with the Commonwealth Procurement Guidelines.

Contract development

CSIRO advised that the experience gained from earlier NEM contracts had been used in the development of the single 1998 contract for electricity supply in NSW, Victoria and the ACT. For example, legal reviews of proposed contracts were (in 1988) standard, but such a review did not occur for the 1996 Victorian electricity supply contract.

The 1998 contract was the main topic of this case study. The ANAO considers it to be of a high standard in that it includes:

- standard clauses to protect the Commonwealth's interests; and
- provision for the retailer to supply detailed information daily so that electricity accounts and energy use/conservation can be analysed.

There is, however, no clause permitting ANAO or DOFA access to the retailer's records.

Regarding the non-guarantee of electricity supply by the retailer, CSIRO advised that the inclusion of clauses making retailers responsible for quality and continuity of supply was not possible because, under the administrative arrangements of the NEM, they are not directly responsible for generation and delivery. Furthermore, when guaranteed supply at a site was necessary, back-up generators were installed.

Contract management

The EMU established working relationships with the supplier during contract negotiations and has been in regular contact with it. Follow-up of requirements has occurred when necessary.

Continuous improvement

CSIRO has continuous improvement systems and procedures in place evidenced by the adjustment of procurement processes, improved contracts and the development of electricity billing and consumption monitoring and analysis systems and procedures.

As a result of the acquisition of sophisticated on-line electricity meters located at each of its contracted sites, and analysis of detailed consumption information from them:

- electricity bills can be confirmed. CSIRO advised that incorrect billing was a significant element in electricity procurement; and
- energy use can be monitored over time. This can lead to the identification of time periods in which electricity consumption can be reduced. In addition, consumption profiles can be established, resulting in greater certainty of energy requirements. A high level of certainty in energy requirements is a significant factor in negotiating better prices.

Common user arrangements and collaborative procurement

The September 1998 contract does not include a clause providing for non-CSIRO sites to become party to the contract and therefore take advantage of CSIRO's buying power and procurement activities. CSIRO has advised, however, that it is prepared to negotiate for such a clause in future contracts.

Open and effective competition

In seeking requests-for-tender, CSIRO approached all known electricity retailers. Each received the same information, including details of how information was to be presented and a copy of the proposed contract. Unsuccessful tenderers were advised as required, including an offer to provide further advice on request. Short-listed tenderers were advised of their status, and again when the successful tenderer was known.

Ethics and fair dealing

The ANAO found no evidence to indicate that CSIRO had acted unethically or unfairly in relation to the electricity procurement case study.

Accountability and reporting

Examination of CSIRO's files indicates that:

- an adequate management trail had been maintained. This was evidenced by the content of the files including details of NEM matters, key documents, records of negotiations, meetings and legal advice;
- the Minister had exercised his delegation in approving the contract. This approval had not been sought until due-diligence and viability checks of the successful tenderer had been completed; and
- CSIRO had not reported the contract through the Telstra Transigo reporting system as required by the Commonwealth Procurement Guidelines.

National Competitiveness and Industry Development

The CSIRO contract complied with the spirit of the National Competition Policy in that it offered the opportunity for competitive bidding by all licensed retailers.

Conclusions

In summary, CSIRO:

- has benefited from central procurement from both an administrative and price perspective through a single procurement process and bulk or collaborative buying;
- is using information gained from sophisticated electricity meters to monitor electricity consumption in detail for bill reconciliation and energy efficiency/conservation management;
- did not make formal use of the Commonwealth Procurement Guidelines (no references to them were found in the files). However, records of CSIRO's procurement activities indicate that they were consistent with the six Guideline principles;
- has established an Energy Management Unit specifically to facilitate energy conservation and reduced energy costs; and
- has developed a good knowledge of the NEM, with the capacity to analyse the market with a view to identifying past and future market conditions and prices.

Case study 3

Department of Defence

Reasons for selecting the Department of Defence for a case study

The Department of Defence was chosen as a case study because it:

- is the Commonwealth's largest consumer of electricity;
- has been a NEM participant since 1996,
- uses central electricity procurement and administrative systems and procedures;
- has several contracts; and
- includes in some of its contracts a clause permitting other agencies to become party to them.

Although the 1998–99 contracts were of primary interest in this case study, the ANAO reviewed Defence's electricity procurement activities since 1996 in order to understand how procurement systems and procedures had developed.

Defence overview

Defence is the largest single consumer of electricity among Commonwealth agencies. In 1997–98 it accounted for about 45 per cent of all Commonwealth consumption. Of its total consumption, 72 per cent occurred in the NEM.

Defence entered the NEM when Victoria began electricity deregulation in 1995. Initially, contracts were negotiated on a regional and, in some cases, individual-program basis within the Department. This was consistent with its then administrative support arrangements. Since September 1997, administrative responsibility for electricity, including procurement and the payment of accounts, has been centralised in Defence Corporate Support in Canberra.

Development of electricity procurement in Defence

August 1996—Victoria

The first Defence contracts were signed in Victoria in August 1996. Savings in the first year of the contract were about 8 per cent, or \$700 000. Some sites were not included because, under then market conditions, it was cheaper for them to remain on existing electricity prices. The contracts signed were similar to the pre-NEM electricity supply agreements.

February 1997—Australian Capital Territory

In February 1997, Defence signed a supply contract with the existing supplier involving a number of sites in the ACT. At the time, the ACT had not entered the NEM, so only the local supplier was legally able to contract for supply. Savings of about \$100 000 a month were anticipated. The option to extend the contract was taken in September 1997.

These sites therefore obtained a lower price before deregulation in the ACT. The length of time (8–17 months) that the lower price applied depended on when each site became eligible to enter the NEM; see Table B.

Table B

Price advantage of sites included in the Defence contracts

<i>Number of Sites</i>	<i>Date when new contract price started</i>	<i>Month the sites became eligible to enter the NEM</i>	<i>Price Advantage (Months) (a)</i>
<i>A</i>	<i>B</i>		<i>(A–B)</i>
<u>Initial contract:</u>			
6	1 Feb 97	Mar 98	13
7	1 Feb 97	May 98	15
2	1 Feb 97	Jul 98	17
<i>Sub total 15</i>			
<u>Contract extension</u>			
3	1 Sep 97	May 98	8
12	1 Sep 97	Jul 98	10
<i>Sub total 15</i>			
Total 30			

Note: (a) *Price advantage* means the difference between the existing pre-deregulation electricity prices and the more favourable prices negotiated within the contract prior to deregulation.

July 1997—New South Wales and Victoria

The contract included 40 sites in NSW and 10 sites in Victoria. The anticipated savings from this contract were 30 per cent, or \$6 million, in its first year. A consultant was used to help assess responses to the request-for-tender.

September 1997—Australian Capital Territory

Regarding the February 1997 contract, the ACT electricity supplier offered a reduced price in September 1997, on the condition that the contract be extended an additional year. Defence insisted on and obtained an option to exit the contract after two years, but paid a larger price than that offered. An additional 15 newly eligible Defence sites in the ACT joined this contract (See Table B). Defence took the 'exit option' in 1999.

1998–99 Across market contracts—Victoria, Queensland and South Australia

In April and May 1998 Defence sought expressions of interest for the supply of electricity in Victoria, Queensland and SA. A consultant was used in assessing the responses. As a result:

- all eligible sites in Victoria were placed on contract. Savings of 31 per cent in the first year of the contract were expected. Because of the expected price escalation over the life of the contract, the level of savings was also expected to reduce.
- in South Australia no suitable offers were received because of uncertainty as to when and how SA would enter the NEM. In addition, Defence advised that it did not want to enter the NEM in SA until the market had begun and Defence had a chance to assess market conditions and trends; and
- in Queensland four of six eligible Defence sites were placed on contract. The peculiarities of Queensland network charges, which are decided on a site-specific basis, determined the viability of contracts and thus the number of sites to be included. The average savings at the four sites included in the contract was about 11 per cent.

Application of the Commonwealth Procurement Guidelines

Price and quality

Defence electricity procurement contracts have resulted in better VFM for the Commonwealth. Although Defence acknowledges that more than price alone should be considered in achieving VFM, the choice of electricity retailer has been based primarily on price.

The electricity retailers generally do not guarantee continuity (quality) of electricity supply and included clauses in the contracts to that effect.

Value-added-services

Examination of Defence files shows that the availability of VASs has been a factor in Defence's contract negotiations. VASs have included typically the supply of such services as:

- enhanced billing information (including cost comparisons) and billing arrangements;
- daily information for the purposes of developing energy use profiles of individual sites;
- 'meet-the-market' provisions—a mechanism that ties prices more closely to spot prices; and

- energy-consumption analysis and energy management services and advice.

The consultant used to help with procurement activities tried to put a monetary value on VASs but found it too complex.

Procurement process

Examination of Defence's procurement process reveals that it was generally effective and efficient. The securing of electricity supply evidences effectiveness. Efficiency is suggested by comparing the savings with the cost of arranging and managing the contract. A small team, which costs the Defence \$350 000 annually, negotiated contracts with millions of dollars worth of savings. The team performs other, continuing energy and utility management tasks simultaneously. Table C summarises the estimated savings achieved.

Table C
Estimated savings

<i>Agency</i>	<i>Contract start</i>	<i>Contract term (years)</i>	<i>Estimated savings in the first year of contracts (in \$ millions)(a)</i>
Defence	1996	2	0.7
Defence (b)	1997&1998	2–5	1.2–6

Note: (a) per-annum savings cannot be calculated because most contracts have price review clauses that will alter the estimated savings.

(b) the detail provided is a consolidation of information for contracts in the ACT, NSW, Qld and Vic.

Defence has taken advantage of the experience obtained progressively since the first electricity purchases occurred in the deregulated Victorian market in 1996. Its improvement of procurement systems and procedures support this finding. For example:

- although procurement and billing are central, Defence Corporate Support takes steps to involve officers of the regional sites;
- in-house specialised expertise is maintained;
- regular reviews and assessments of the NEM and Defence's electricity requirements occur. Consultants are used to supplement this knowledge;
- timetables were developed for keeping the contract process on schedule;
- systems and procedures for undertaking and recording an inclusive tendering process exist and are implemented;

- steps were taken to develop a sound working relationship with the successful tenderer during both detailed contract negotiations and the term of the contract;
- proposals for contract variations were subject to legal review; and
- arrangements were made to record the various contracts by including them in Transigo.

The ANAO did not identify any documents confirming that due-diligence and viability checks of the successful tenderer were completed. The ANAO notes that the National Electricity Code places prudential requirements on wholesalers and retailers in the National Electricity Market.

Contract development

The 'base' contract being used now by Defence has been improved progressively since the first contract was signed. Among other things, Defence used a national legal firm to ensure that the 'base' contract was appropriate Australia-wide. Practicable and reasonable clauses to protect the Commonwealth's interests are included.

The ANAO considers that the most recent contracts are of a high standard and reflect best practice. For example, the contracts:

- place precise obligations on the retailer for accounts and billing procedures;
- provide for discounts for early payment of accounts;
- define VASs;
- specify mechanisms for dispute resolution;
- specify termination circumstances and protect the Commonwealth against penalties;
- define the liability of the contracting parties;
- protect the Commonwealth against claims by the retailer for loss of profit;
- include clauses relating to supply disruptions; and
- include the Commonwealth's right to review prices (with other retailers) after an agreed period and to give the contracted retailer the opportunity to better these prices.

There is, however, no clause permitting ANAO or Defence access to the retailer's records.

Contract management

Examination of Defence's files show that there is continuing dialogue between Defence and its electricity retailers and that a contract-monitoring and consultation/review system exists; this includes verification of electricity bills. Follow-up action by Defence occurs when required.

Continuous improvement

As identified earlier, Defence has continuous-improvement systems and procedures. Examples other than those mentioned already include:

- changing the organisational structure to support central electricity procurement and energy management. Defence advised that significant savings have resulted from the centralisation of account processing, consolidation of accounts for many sites into a single bill from individual suppliers and the elimination of clerical double handling;
- developing standard request-for-tender/request-for-quotation procedures;
- introducing billing and energy-consumption software compatible with the requirements of the NEM;
- establishing a Defence-wide energy-conservation project;
- negotiating with retailers a contract clause permitting other agencies to become party to the contract;
- developing and maintaining NEM market-trend information and experience, including liaising with suppliers and energy-industry companies; and
- liaising with other agencies to share procurement knowledge and experience.

Common user arrangements and collaborative procurement

Whole-of-government considerations have been included in contracts by making provision for non-Defence sites to join them. Defence relies on the Government Operations Team of the Australian Greenhouse Office to conduct detailed negotiations/advocacy for other agencies interested in being included in Defence contracts.

Other markets

Discussions, still at an early stage, have been initiated with the Northern Territory Power and Water Authority. Noting the present level of expenditure on electricity, and depending on the size of any reductions that might be negotiated, the ANAO considers that the results of these discussions could be important. For example, in 1997–1998 expenditure

in the Northern Territory accounted for almost 20 per cent of Defence's electricity costs. Relative to total consumption, this is significantly more than in the states and the ACT. The average cost in the NT is more than twice the average of the States and the ACT.

Defence advised that while it is interested in negotiating an electricity supply contract in the NT as soon as possible, deregulation of the NT electricity market has been delayed.

Use of consultants

Defence has used a consultant three times to help with the electricity-supply tendering process. Consultants' activities have included:

- advising on consumption profiles, electricity use management, the quality of supply, metering requirements and VAS;
- educating and advising staff at sites being placed on contract;
- collecting, collating and analysing site data for use in requests-for-tender/quotations;
- evaluating expressions of interest, quotes and tenders; and
- helping tender-evaluation boards.

Open and effective competition

Examination of Defence's files shows that open tendering processes are being implemented. All known electricity retailers have been approached. All retailers received the same information and unsuccessful tenderers have been advised appropriately. Short-listed tenderers were been advised of their status, and again once the successful tenderer has been chosen. Tender-evaluation boards have been established and appropriate procedures, including records of their proceedings, have been used.

Ethics and fair dealing

The ANAO found no evidence to suggest that Defence had been unethical or dealt unfairly in relation to electricity procurements.

Accountability and reporting

Examination of Defence's files shows that Defence has established an adequate procurement management trail that identifies plans, decisions, actions and outcomes. In addition:

- appropriate delegations and responsibilities were adhered to. Senior Defence staff were involved in various approvals, including the latest contract negotiations. In earlier contracts, when deregulation and the savings being made were a new feature, the Minister was briefed;

- those approving the case-study procurements demonstrated appropriate competencies; and
- the Telstra Transigo reporting requirements required by the Commonwealth Procurement Guidelines were complied with.

National Competitiveness and Industry Development

With the minor exception of the 1997 contract in the ACT, the ANAO considers that the Defence contracts for the supply of electricity have met the intention of the National Competition Policy in that they have provided the opportunity for competitive bidding by all licensed retailers.

In the ACT, the 1997 contract could have resulted in the opportunity for market testing being delayed for 2½ years after deregulation of the ACT market. The ANAO notes, however, that this contract preceded market deregulation in the ACT and that Defence took the option it had negotiated to leave the contract to test the market.

Support for other Commonwealth policies

Examination of Defence's files shows that only the following Government policies have been considered in the procurement process:

- energy efficiency;
- greenhouse gas; Defence advises that the ACT electricity-supply contract signed in August 1999 provides for some procurement from 'green' generators; and
- some requests-for-tender have required tenderers to comply with the Government's equal-opportunity legislation and have drawn attention to legislation concerning Aboriginal and Torres Strait Islander employment.

Conclusions

In summary, in Defence:

- an over-all active response to electricity-market deregulation has occurred;
- the various contracts have achieved substantial reductions in prices;
- the bargaining strength of Defence in negotiating agreements has been increased by its having the capacity to coordinate and group electricity buying centrally. Central coordination of energy management is facilitated by these arrangements, resulting in significantly better information for energy management;

- reasonable information about individual sites' electricity requirements was developed before contracts were negotiated; however, in some cases this information was lacking in detailed energy-consumption profiles;
- those responsible for procurement had a sound knowledge of the NEM, supplemented by consultants engaged to help with pre-contract preparation and tender evaluation;
- detailed procurement instructions have been developed which provide a formal framework for electricity procurement, contract preparation, engagement of consultants and contract management. These instructions are consistent with the requirements of the Commonwealth Procurement Guidelines; and
- contracts provide for the daily provision of detailed consumption information needed for examination and analysis of electricity accounts and for energy management.

Appendix 2

Summary of Criteria used for Case Study examination

The criteria used in the examination of the case studies drew on DOFA's competitive tendering and contracting documents, including the Commonwealth Procurement Guidelines, the Defence Procurement Policy Manual, MAB/MIAC Report No.23, ANAO audit reports and better practice guides. Commonwealth procurement circulars, various Australian Standards Association standards dealing with contracting, and Government policies dealing with, for example, energy and national competition policy, were reviewed also.

The criteria are worded in the form of questions.

Value-for-money

1. Has VFM been achieved in the procurement of electricity; or alternatively is the agency entering into a financial commitment/s for the procurement of electricity satisfied that the Commonwealth is unable to obtain better value-for-money?
 - Was the best price achieved. For example, was a whole-of-life analysis technique used?
 - Was the best quality product obtained?
 - Did the Commonwealth obtain the right to alter the circumstances of the contract without penalty?
 - Is the Commonwealth's intellectual property protected?
 - Have all risks associated with the contract been ameliorated?
 - Are prevention systems and procedures in place for non/underperformance against minimum specifications?
 - Are compensation systems and procedures in place for non/underperformance against minimum specifications?
 - Has the Commonwealth maximised the number of, and benefits from, value-added-services?
 - Is effective and efficient contract management enabled?
2. Was the procurement process efficient and effective?

3. Were the appropriate parts of the standard rational decision-making process followed?
 - Did the agency prepare adequately for the contractual relationship?
 - Did the agency identify adequately its business and contractual objectives?
 - Did the agency identify and plan for risks adequately?
 - Did the agency plan for/develop a non-adversarial-partnering relationship with the contractor?
 - Did the agency formally assess alternative tender contract types and contract procedures?
 - Did the agency comply with the Guidelines' tender-evaluation requirements?
 - Was contract management established/achieved adequately?
4. Were inefficient and ineffective activities in the procurement process identified and addressed?
5. Were the Commonwealth's interests protected?
6. Were whole-of-government considerations taken into account?
7. Were continuous-improvement systems and procedures implemented?

Open and effective competition

1. Were suppliers provided with reasonable access to the procurement opportunity, for example through appropriate advertising?
2. Did the agency encourage and promote effective competition to the extent practicable?
3. Did the agency ensure that its procurement systems and procedures are open and transparent?

Ethics and fair dealing

1. Did the agency have procurement systems and procedures in place to eliminate bias and favouritism?

Accountability and reporting

1. Was an adequate management trail maintained which included recording of all relevant procurement plans, decisions, actions and outcomes?
2. Were appropriate delegations and responsibilities delineated and were they adhered to?
3. Were the reporting requirements adhered to, including Transigo reporting?

National competitiveness and industry development

The ANAO considered that examination of the National Competitiveness and Industry Development principle was not warranted in this audit, given that the establishment of the deregulated electricity market through the NEM was a direct result of the 1993 National Competition Policy and the 1995 Competition Principles Agreement.

Support for other Commonwealth policies

1. Were other, appropriate, Commonwealth policies considered?

Appendix 3

Extract from the *Financial Management and Accountability Regulations 1997*

Financial Management and Accountability Regulations 1997; specifically Part 4 dealing with commitments to spend public moneys.

PART 4—COMMITMENTS TO SPEND PUBLIC MONEY

7 Commonwealth Procurement Guidelines

- (1) The Finance Minister may issue guidelines (to be called ‘Commonwealth Procurement Guidelines’) about matters relating to the procurement of property and services, including:
 - (a) matters affecting Commonwealth contracts or agency agreements; and
 - (b) the publication of details of Commonwealth contracts and agency agreements; and
 - (c) the disposal of public property.
- (2) Commonwealth Procurement Guidelines must not be inconsistent with:
 - (a) the Act; or
 - (b) these Regulations; or
 - (c) FMA Orders.
- (3) Commonwealth Procurement Guidelines may require that a matter must be published in the Gazette.

8 Officials to have regard to guidelines

- (1) An official performing duties in relation to the procurement of property or services must have regard to the Commonwealth Procurement Guidelines.
- (2) An official who takes action that is not consistent with the Guidelines must make a written record of his or her reasons for doing so.

9 Approval of spending proposals—principles

- (1) An approver must not approve a proposal to spend public money (including a notional payment within the meaning of section 6 of the Act) unless the approver is satisfied, after making such inquiries as are reasonable, that the proposed expenditure:
 - (a) is in accordance with the policies of the Commonwealth; and
 - (b) will make efficient and effective use of the public money; and
 - (c) if the proposal is one to spend special public money, is consistent with the terms under which the money is held by the Commonwealth.
- (2) Sub-regulation (1) does not apply to a proposal by an intelligence or security agency to spend operational money within the meaning of section 5 of the Act as modified in accordance with Schedule 2.

10 Approval of future spending proposals

If any of the expenditure under a spending proposal is expenditure for which an appropriation of money is not authorised by the provisions of an existing law or a proposed law that is before the Parliament, an approver must not approve the proposal unless the Finance Minister has given written authorisation for the approval.

11 Approval of spending proposal—Parliamentary Secretary or official

A Parliamentary Secretary or official must not approve a proposal to spend public money unless authorised by a Minister or Chief Executive, or by or under an Act, to approve the proposal.

12 Approval to be recorded

If approval of a proposal to spend public money is not given in writing, the approver must record the terms of the approval in a document as soon as practicable after giving the approval.

[NOTE: ‘Document’ is not limited to paper documents: Acts Interpretation Act 1901, s 25.]

13 Entering into contracts etc

A person must not enter into a contract, agreement or arrangement under which public money is, or may become, payable (including a notional payment within the meaning of section 6 of the Act) unless a proposal to spend public money for the proposed contract, agreement or arrangement has been approved under regulation 9 or 10.

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