

The Auditor-General  
Audit Report No.58 2001-02  
Performance Audit

## **Defence Property Management**

**Department of Defence**

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of Australia 2002

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Canberra ACT  
17 June 2002

Dear Madam President  
Dear Mr Speaker

The Australian National Audit Office has undertaken a performance audit in the Department of Defence 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 *Defence Property Management*.

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

A handwritten signature in black ink, appearing to read 'P. J. Barrett'.

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

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**The Publications Manager**  
**Australian National Audit Office**  
**GPO Box 707**  
**Canberra ACT 2601**

**Telephone:** (02) 6203 7505  
**Fax:** (02) 6203 7519  
**Email:** [webmaster@anao.gov.au](mailto:webmaster@anao.gov.au)

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### Audit Team

Nicola Thatcher  
Vicky Delgos

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# Abbreviations

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ADF	Australian Defence Force
ANAO	Australian National Audit Office
CEI	Chief Executive's Instruction
CMC	Comprehensive Maintenance Contract
CSA	Customer Service Agreement
CSIG	Corporate Services and Infrastructure Group
CUC	Capital Use Charge
DEMS-FM	Defence Estate Management System—Facilities Maintenance
DEO	Defence Estate Organisation
DPS	Directorate of Property Services
FMA Act	<i>Financial Management and Accountability Act 1997</i>
ID	Infrastructure Division (formerly DEO)
JCPAA	Joint Committee of Public Accounts and Audit
KPIs	Key Performance Indicators
MI	Managers—Infrastructure
PBS	Portfolio Budget Statements
ROMAN	Resource and Output Management and Accounting Network
RICs	Regional Infrastructure Centres
SPDE	Strategic Plan for the Defence Estate



# **Summary and Recommendations**



# Summary

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## Background

1. Defence property comprises the land, buildings and infrastructure that Defence uses across Australia. These facilities assist the Australian Defence Force (ADF) maintain its capability and assist in achieving the Defence outcome, that is, the defence of Australia and its national interests.
2. Defence property acquisition, use and disposal are of some considerable interest to Defence personnel and the community. Defence property has significant revenue and expenditure implications for the Commonwealth. As at 30 June 2001, Defence land, buildings and infrastructure assets had a gross value of \$15.4 billion. After deducting accumulated amortisation and depreciation of buildings and infrastructure assets, the net book value was \$11.1 billion. Defence has three million hectares of land, 360 separate owned properties and numerous property leases.
3. Defence Estate Organisation (DEO) was formed in 1997 to manage the Defence estate 'building owner' functions as a single coordinated task except for tenant responsibilities, which were to be devolved to individual Defence groups. In July 2001, DEO became Infrastructure Division (ID) in the new Corporate Services and Infrastructure Group (CSIG), which was formed as an 'integrated' service provider.
4. The Directorate of Property Services (DPS) in ID's Estate Management Branch is the central coordination point for Defence property management activities. DPS is assisted in the delivery of property management services by staff located in the 12 Regional Infrastructure Centres around Australia.
5. The objective of the audit was to assess the efficiency of Defence property management; provide assurance that probity and compliance requirements are being met; and make practical recommendations for enhancing property operations. The audit sought to understand policy requirements and planning processes relevant to property and the procedures for meeting facilities needs of Defence capabilities. The audit focused on ID's property management, with recognition that other areas manage certain property service contracts, such as those for electricity supply and cleaning.

## Conclusion

6. Infrastructure Division's staff are responsive to individual Defence clients' property needs. Its property management is, however, largely reactive to emerging needs and lacks the proactive approach that a task of this magnitude

calls for. A more structured approach would accord with *The Commonwealth Property Principles*, which call for an assessment of the long-term yield, or public interest considerations, of Defence's properties and disclosure of the costs.

7. A joint Defence and Finance review of Defence estate management in 2000 indicated that Defence should introduce an effective system for reporting all property costs. It would seem desirable to implement such a system and to disclose property costs. Available data indicate that Defence property costs amount to \$1.9 billion a year. These include a Capital Use Charge of \$1.2 billion but, as the Charge is not linked to individual assets or the users of those assets, its effect as an incentive for better asset management relating to property holdings has been minimal.

8. The joint review also indicated a need for a more transparent separation of landlord and tenant responsibilities, with an internal rent regime. In effect, this is scheduled to be implemented by means of Defence's customer-supplier model, and introduction of Customer Service Agreements with Defence 'customers' in 2002–03. The Agreements prepared to date would benefit from further review as well as more reliable data on property costs and usage to ensure they provide a sound basis for charging for property services to clients.

9. Infrastructure Division is aware that it has not issued policy and procedural guidance to staff on matters relevant to property management. It has engaged a consultant to assist in remedying this. Among other things, guidance of this kind would help overcome regional variations in procedures observed during the audit.

10. Management of Defence's numerous property leases was outsourced to the private sector in 1998. Improvements could be made to Defence's management of the contract in the areas of performance monitoring; payment procedures; electronic funds transfer; granting of revenue leases; and collection of debts on revenue leases.

11. Discussions with Defence in April 2002, at the close of the audit, indicated that senior executives in CSIG and ID were aware of the need to make changes. They had proposals in hand for the next step in implementing the CSIG Business Model and to improve the integration of CSIG's three Divisions. A major reorganisation would aim to deliver services in a manner seen by clients as seamless, consistent across regions and responsive to their changing needs.

# Key Findings

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## Property Policy Requirements and Planning—Chapter 2

12. Commonwealth property management is subject to requirements in legislation and government guidelines and principles. *The Commonwealth Property Principles* outline the basis for continued ownership and development of Commonwealth property. They call on agencies to assess the long-term yield or public interest considerations of properties, and to disclose the costs of property use in the interests of efficient and effective decision-making and accountability. This is still to be done in respect of Defence properties.

13. As a result of the Defence White Paper in 2000, the *Defence Plan 2001–11* and *Defence Financial and Management Plan 2001–11* were developed. Both plans make minimal mention of Defence property management issues, even though the Defence Efficiency Review in 1997 stated that estate management and planning was to be effectively linked into overall defence strategic planning.

14. The Strategic Plan for the Defence Estate (SPDE), developed in 1998, identifies key criteria to be considered in any rationalisation and consolidation of the estate. Management information to enable consideration of these criteria is not readily available. There is little evidence of the criteria being applied in the day-to-day management of the estate.

## Defence Property Management—Chapter 3

15. A recent internal review brought to notice a need to attend to various CSIG service delivery issues, including National Office support for the regional offices, staff training, and integration and definition of services. Remedial action is in hand.

16. With the frequent restructuring of service delivery areas in Defence, there is little property management policy and procedural guidance. As a result, there is a wide variation in the services delivered to clients and the level of management information available.

## Customer Service Agreements—Chapter 4

17. CSIG is progressively developing Customer Service Agreements (CSAs) with its customers (Defence's Output and other Enabling Executives). Defence expects that CSAs will bring about closer linkages between customer activity levels and the provision of corporate services and infrastructure support, in a timely, cost effective and efficient manner.

18. The CSA implementation process has been challenging, given the difficulties in understanding and/or identifying the costs of individual activities. CSIG staff are focusing on the development and improvement of the 2002–03 CSAs.

## **Property Information—Chapter 5**

19. Poor access to the main information systems that contain data on Defence properties, and inconsistencies in that data, have led to unnecessary duplication of effort in establishing numerous subsidiary information systems of limited value. There is a continuing need for reliable data on Defence property location, value, occupancy and utilisation. The data is required not only for daily property management, but also for CSAs and to meet the requirements of *The Commonwealth Property Principles*. Data on property values is included in Defence's annual financial statements.

## **National Property Services Contract—Chapter 6**

20. Under the national property services contract, a private-sector property management firm arranges payment for Defence of some \$30 million a year in rent and collects some \$5 million a year in rent from Defence's tenants. Legal advice indicates that present arrangements for the management firm, as Defence's agent, to hold rent due, by and to Defence, need to be amended to comply with the *Financial Management and Accountability Act 1997*.

21. Some Defence regional staff involved in management of the contract are not clear on the content of the property services contract or on the delineation of responsibilities between Defence and the management firm. Central office management could be improved by better scrutiny of contractor performance and invoices.

22. Payment of rent due by Defence to the management firm earlier than required under a lease results in interest forgone by the Commonwealth. Defence argues that, with the large number of properties involved, it is not practicable for it to deal directly with the lessees to minimise this loss.

23. Defence is formalising 'revenue lease' arrangements with contractors and other non-Defence personnel using Defence facilities, although there are still many unidentified occupants. Revenue due on such leases should be monitored and recovery action on outstanding debt taken in accordance with Defence's responsibilities to pursue recovery of debts due to it.

24. The timing of a new contract for national property services has not yet been decided. Defence has indicated that, in renewing the contract, it will take account of issues raised in this report.

## Response to the audit

25. Defence agreed, or agreed in principle, with the ANAO recommendations. Defence found the report to be reasonably balanced and a useful assessment of where property management is at present on the eve of reconsidering the property services contract and, more importantly, the realignment of Corporate Services and Infrastructure Group (CSIG) businesses.

# Recommendations

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Set out below are the ANAO's recommendations, with report paragraph references and an indication of the Defence response.

**Recommendation  
No.1  
Para 2.39**

The ANAO recommends that Defence collate data on the full cost of owning and operating the Defence property portfolio, and on actual usage of properties, to assist in Defence estate planning, benchmarking and management, and to enhance accountability.

*Defence response:* Agreed in principle.

**Recommendation  
No.2  
Para 4.30**

The ANAO recommends that Defence ensure that, in the Customer Service Agreements between CSIG and its 'customers':

- a) the property service elements provide for 'units to measure' and 'cost drivers' that are supported by reliable and current data on property costs and usage; and
- b) provision is made for adequate planning and communication of facilities needed to satisfy revised capability requirements.

*Defence response:*

- a) Agreed in principle.
- b) Agreed.

**Recommendation  
No.3  
Para 5.24**

The ANAO recommends that Defence endeavour to establish an authoritative, reliable and accessible system for recording both accounting and management data on the location, value, occupancy and utilisation of each property in the Defence estate.

*Defence response:* Agreed.

**Recommendation  
No.4  
Para 6.69**

The ANAO recommends that, to improve management of the property services contract, Defence:

- a) provide Infrastructure Division's regional property management staff with clear guidance on the delineation of responsibilities between Defence and the management firm;
- b) ensure that financial arrangements with the management firm, as Defence's agent under the contract, comply with the *Financial Management and Accountability Act 1997*;
- c) ensure appropriate processes are in place for 'line managers' to authorise claims for payment against the relevant contract; and
- d) ensure that revenue leases and licences are issued and recorded and that collection of revenue from them is monitored.

*Defence response:* Agreed.

**Recommendation  
No.5  
Para 6.71**

The ANAO recommends that, to assist in formulating a new property management contract that would give best value to the Commonwealth, Defence:

- a) collate data on the cost of managing the relevant contract, and the management fees paid, for benchmarking with industry standards and to assist in assessing tenders for the replacement contract; and
- b) engage suitable expertise to advise on terms, conditions and key performance indicators for the new contract.

*Defence response:*

- a) Agreed in principle.
- b) Agreed.



# **Audit Findings and Conclusions**



# 1. Introduction

---

*This chapter describes the Defence estate, the audit and the report structure.*

## Defence estate

**1.1** Defence property comprises the land, buildings and infrastructure that Defence<sup>1</sup> uses across Australia. These facilities assist the Australian Defence Force (ADF) maintain its capability and assist in achieving the Defence outcome: the defence of Australia and its national interests.

**1.2** Defence property acquisition, use and disposal are of significance to Defence personnel and the community. Defence property has significant revenue and expenditure implications for the Commonwealth. As at 30 June 2001, Defence land, buildings and infrastructure assets had a gross value of \$15.4 billion and a net book value of \$11.1 billion.<sup>2</sup> They comprise:

- 360 separate owned properties;
- three million hectares of land;
- 120 properties identified for potential disposal or being prepared for sale; and
- 371 'expenditure leases' (Defence as lessee) and 676 'revenue leases' (Defence as lessor).

**1.3** The Defence Efficiency Review<sup>3</sup> recommended that the Defence estate be managed as a single coordinated task except for devolved only for tenant responsibilities, such as minor fitout and housekeeping, which would be devolved to the individual Defence groups. Defence Estate Organisation (DEO) was formed on 1 July 1997 to manage the 'building owner' functions on a national basis.

**1.4** On behalf of the Defence portfolio, DEO was to manage the estate as 'corporate assets'. In assuming ownership and management responsibilities for the entire Defence estate, a commercial landlord/tenant approach was to be adopted between DEO and other program areas as far as possible with due cognisance of functional implications, legal obligations, government directives and community expectations.

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<sup>1</sup> 'Defence' comprises the Department of Defence and the Australian Defence Force, which in turn comprises the three Services: Navy, Army and Air Force.

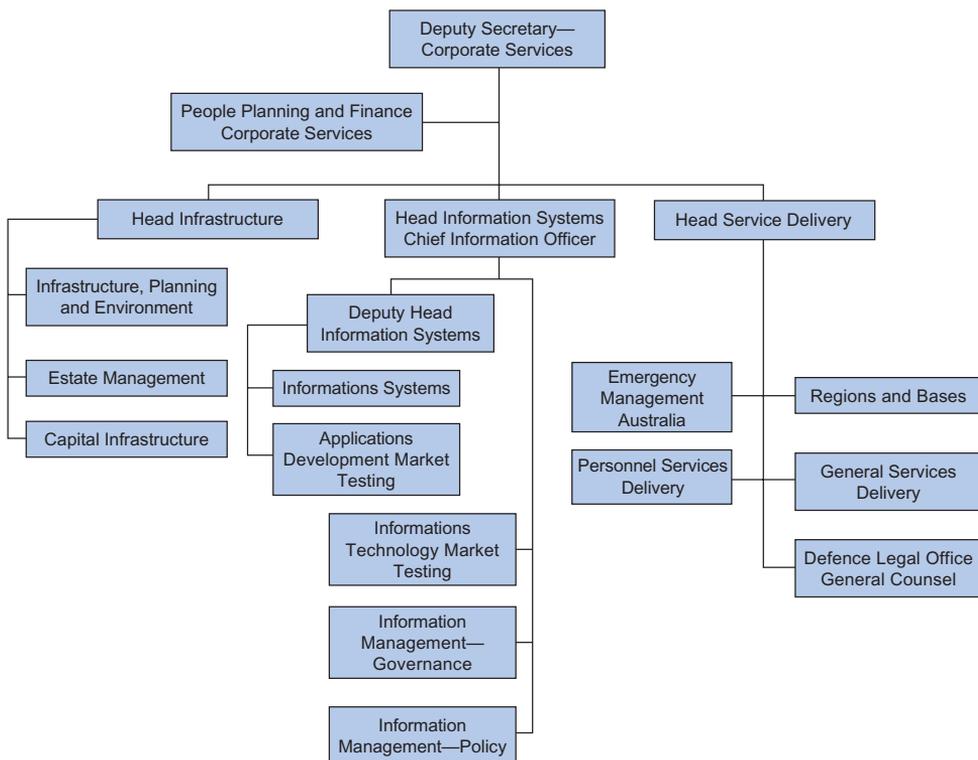
<sup>2</sup> These figures, from CSIG Asset Policy and Accounting, are reflected in the financial statements in the *Defence Annual Report 2000–01*. Gross value is equivalent to cost of acquisition or any subsequent revaluation. Net book value is gross value after deducting accumulated depreciation or amortisation.

<sup>3</sup> *Future Directions for the Management of Australia's Defence, Report of the Defence Efficiency Review*, March 1997, R33, p. E-6.

1.5 When DEO was formed, it was as a stand-alone program, with the head of Defence Estate reporting to the Deputy Secretary Corporate. In July 2000, DEO became part of the Corporate Services Enabling Group. By July 2001, this group was known as the Corporate Services and Infrastructure Group (CSIG). CSIG amalgamated DEO, Defence Corporate Support (DCS) and Defence Information Systems (DIS) into an ‘integrated’ service provider. At that time, the program areas were ‘re-badged’ as three Divisions: DCS became Service Delivery Division, DIS became Information Services Division and DEO became Infrastructure Division (ID). ID is responsible for property management and other estate functions.

1.6 Creation of CSIG was expected to yield administrative and overhead savings while increasing effectiveness.<sup>4</sup> The CSIG National Office structure as at November 2001 is illustrated in Figure 1.

**Figure 1**  
**CSIG National Office Structure**



Source: Defence Functional Directory, November 2001.

<sup>4</sup> *Defence Financial and Management Plan 2001–2011*, Annex p. 53.

1.7 ID Regional Infrastructure Centres report to the Estate Management Branch. Service Delivery regional offices have a separate branch head in the central office structure reporting to the Head, Service Delivery.

## The audit

1.8 The performance audit on Defence property management was the third in a series of audits reviewing aspects of Defence Estate management. The first audit reviewed the project delivery function.<sup>5</sup> The second audit focused on the facilities operations (FACOPS) program.<sup>6</sup> The report of the second audit was reviewed by the parliamentary Joint Committee of Public Accounts and Audit (JCPAA).<sup>7</sup> The third audit has reviewed management of Defence's owned and leased estate.<sup>8</sup> The audit was scheduled to begin in 2000 but, when Defence announced changes to Defence estate operations, it was postponed to 2001.

1.9 The objective of the audit was to assess the efficiency of Defence property management; provide assurance that probity and compliance requirements are being met; and make practical recommendations for enhancing property operations. The audit sought to understand policy requirements and planning processes relevant to property and the procedures for meeting facilities needs of Defence capabilities. The audit focused on property management in CSIG's Infrastructure Division, with recognition that other areas in CSIG manage certain service contracts, such as those for electricity supply and cleaning.

1.10 The audit was concerned with Defence's basic management of property use and the availability of information on property use for decision-making. It did not consider acquisition (purchase) or disposal activities, as they have been addressed in recent external reviews.<sup>9</sup>

1.11 Audit criteria were developed to assess the current management arrangements against government and Defence policy and principles relating to property, ID policy and procedural requirements, and agreed contract terms and conditions.

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<sup>5</sup> ANAO Audit Report No.37 1999–2000 *Defence Estate Project Delivery*.

<sup>6</sup> ANAO Audit Report No.26 2000–2001 *Defence Estate Facilities Operations*.

<sup>7</sup> JCPAA Report 385, August 2001, Canberra.

<sup>8</sup> An earlier ANAO audit reviewed other Commonwealth agencies' management of leased office property: Audit Report No.53 2000–2001 *Commonwealth Management of Leased Office Property*.

<sup>9</sup> These reviews include the following:

- Arthur Andersen, *Defence Property Review: Options for the Future of the Defence Estate Organisation (DEO)*, February 2000.
- Consultants V. Heffernan and J.Jamieson, *2001 Review of Defence Estate Property Sales*.
- Oxley Corporate Finance Limited, *Review of the Defence Estate Organisation*, submitted to The Defence Estate Organisation and The Department of Finance and Administration, March 2001.
- Senate Foreign Affairs, Defence and Trade References Committee: Report—*Inquiry into the Disposal of Defence Properties*, September 2001.

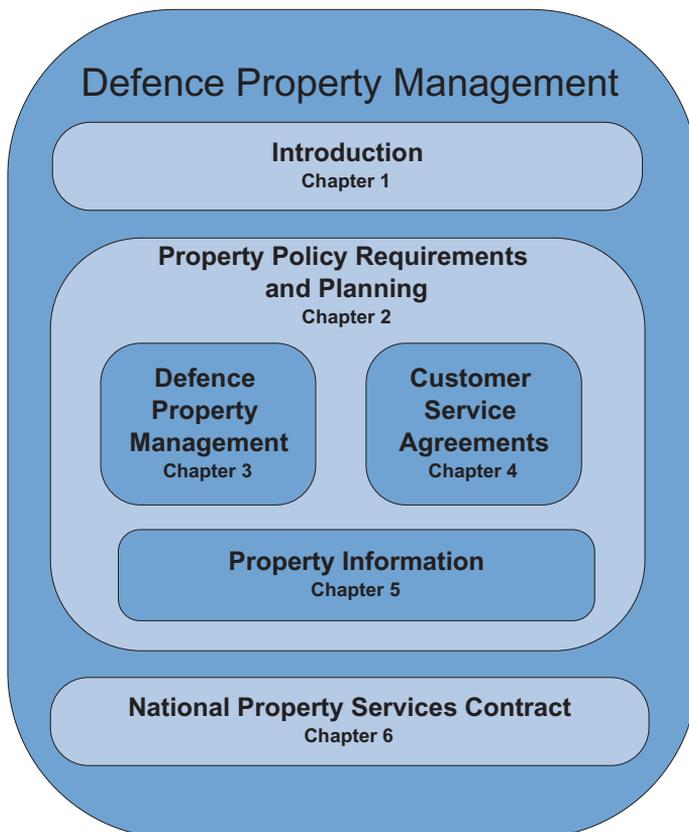
1.12 The audit began in October 2001. Building on the information obtained in the two earlier audits of Defence estate, further fieldwork was carried out between November 2001 and February 2002. The audit encompassed fieldwork at ID's central office in Canberra; RAAF Williams, Laverton; Anglesea Barracks, Hobart; Lavarack Barracks, Townsville; Robertson Barracks, Darwin; Gallipoli Barracks, Enoggera; Defence Plaza, Sydney; and Defence Military Area, Liverpool. Meetings were also held with staff of Defence's contracted property management firm in Melbourne, Darwin, Brisbane, Canberra and Sydney.

1.13 Audit discussion papers were provided to Defence in March 2002. In April the proposed report of the audit was provided to Defence and Chapter 6 of the report was provided to Defence's property management firm. The report was completed having regard to the comments they provided in May. The audit was conducted in conformance with ANAO Auditing Standards and cost \$200 000.

## Report structure

1.14 Figure 2 illustrates the structure of the audit report.

Figure 2



## 2. Property Policy Requirements and Planning

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*This chapter sets out Commonwealth requirements relating to agencies' property holdings and higher-level Defence planning relevant to its property holdings. It also indicates a need for data on Defence property usage and costs.*

### Commonwealth property requirements

2.1 Commonwealth property management is subject to the following legislation, guidelines and principles:

- *Lands Acquisition Act 1989*;
- *Financial Management and Accountability Act 1997* and regulations;
- *Commonwealth Procurement Guidelines*; and
- *The Commonwealth Property Principles*.

#### ***Lands Acquisition Act 1989***

2.2 Acquisition and disposal of any interest in property by the Commonwealth need to be authorised under the *Lands Acquisition Act 1989* (LAA), which is administered by the Department of Finance and Administration.

2.3 Under the *Lands Acquisition Delegation 2001*, three particular Defence officers can provide LAA approval for commercial expenditure leases and staff housing leases. The Department of Finance and Administration is responsible for exercising LAA approval for all other leases, acquisitions and disposals that Defence enters into.

#### ***Financial Management and Accountability Act 1997 and regulations***

2.4 The *Financial Management and Accountability Act 1997* (the FMA Act) and the *Financial Management and Accountability Regulations* provide chief executives of Commonwealth agencies with autonomy in their financial management. Section 44 requires chief executives to manage the affairs of their agency in a way that promotes effective, efficient and ethical use of Commonwealth resources for which they are responsible. Section 52 authorises chief executives to give instructions to their officials on any matter which may be regulated under the Act.

## ***Commonwealth Procurement Guidelines***

2.5 The *Commonwealth Procurement Guidelines*, issued by the Minister for Finance and Administration, specify the Commonwealth's purchasing policy. They provide a policy framework to assist and ensure that Commonwealth agencies achieve value for money in their procurement activities. They apply to the procurement of all property and services.<sup>10</sup> By outlining the fundamental policies and principles that underpin procurement, they articulate the expectations that exist of all officials conducting Commonwealth procurement. Revised guidelines were issued in September 2001.

## ***The Commonwealth Property Principles***

2.6 *The Commonwealth Property Principles* were established by the Government in 1996 and outline the basis for the continued ownership and development of Commonwealth property.<sup>11</sup> The Department of Finance and Administration's Budget Group administers the Principles. The Principles state, inter alia, that the costs of property use (whether owned or leased, domestic or overseas) should be fully reported by the using agency or program, to encourage efficient, effective and transparent decision-making and accountability. The ANAO understands from the Department of Finance and Administration that compliance with this aspect of the Principles is not centrally monitored or enforced. Defence does not report cost information.

2.7 The Principles also state that the Commonwealth should own property only where the long-term yield exceeds the social opportunity cost of capital, or where it is otherwise in the public interest to do so.<sup>12</sup> Public interest considerations include circumstances where the property has national security requirements or strategic significance to future government use. The ANAO notes that, although there has been no formal assessment of the long-term yield, nor of any public interest considerations, in relation to Defence's properties as envisaged by the Principles, a joint Finance and Defence review (see below) has made recommendations on Defence properties for future disposal (see paragraph 2.14).

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<sup>10</sup> 'Property and services' include real property activities; construction and related services; and financial and operating leases for equipment and real property.

<sup>11</sup> *The Commonwealth Property Principles*, Department of Finance and Administration (as at 13 November 2001).

<sup>12</sup> ANAO Audit Report No.4 2001–2002 *Commonwealth Estate Property Sales* reviewed selected examples of the application of the Principles relevant to decisions to retain or dispose of Commonwealth property.

## Joint Defence and Finance review

**2.8** Defence Estate Organisation (DEO) was reviewed in 2000 by a consultant at the joint request of DEO and the Department of Finance and Administration's Budget Group. Reasons for the review included an identified need to maximise accountability and cost transparency of Defence property management.

**2.9** The review had an extensive mandate but focused on overall management of the estate portfolio rather than management of individual establishments. The report, titled *Review of the Defence Estate Organisation*, was submitted to the two organisations on 26 March 2001.

**2.10** The review concluded that the distinguishing factor between the Defence estate and any other estate in Australia is the issue of military capability. Management issues associated with capability preclude the entire estate management being based upon commercial property management principles. The review noted that DEO and Finance had different definitions of capability.

**2.11** The review proposed a new model for management of the Defence estate based on the principles of private sector input at the strategic and operational levels. Review findings associated with the day-to-day management of the Defence estate were minimal. Section 5.4.1 'Current Levels of Private Sector Input' identified that:

... although outsourcing has provided a degree of transparency, the full cost of owning and operating property is not readily available within the current recording and reporting framework. Accordingly the key objectives of this report in relation to accountability and transparency of costs are not being met.

In order to address these deficiencies:

- a more transparent separation of the landlord and tenant responsibilities should be implemented;
- a more transparent recording and reporting of all costs in relation to a property (capital expenditure, operating costs, maintenance costs and running costs);
- an effective and meaningful reporting system should be introduced; and
- the introduction of an internal rent regime should be introduced to reflect price signals to users, where applicable.

Capturing this information will provide the whole of life cost of a particular property, which will in turn support the whole of life cost of an individual capability.

**2.12** Defence and Finance put a joint submission on the review to their Ministers in 2001 but consideration was postponed because of the imminent general elections (held in November 2001).

**2.13** The ANAO noted that separation of landlord and tenant responsibilities, and introduction of internal rents, are both issues being considered in the context of the purchaser-provider model—see Chapter 4. The basic issue raised by the joint review—recording and reporting the full cost of owning and operating property in the interests of accountability and transparency—was still to be addressed. Defence advised in April 2002 that ‘the full cost of owning and operating property could only be benchmarked where costs were captured for the owned and leased estate (expenditure and revenue leases).’<sup>13</sup> This has still not happened. The issue is to be considered in the development of the new property services contract—see Chapter 6.

**2.14** Defence informed the ANAO in May 2002 that, in the context of preparing the 2002–03 Budget, Government returned to the basic findings of the joint review and directed that Defence work more closely and more formally with central agencies to ensure that new property disposal targets are met.<sup>14</sup>

## Defence property planning

### Defence Plan

**2.15** Developed as a result of the Government’s Defence White Paper *Defence 2000: Our Future Defence Force* (December 2000), the Defence Plan aims to guide decisions required to deliver the Defence outputs to Government as defined in the *Portfolio Budget Statements 2001–02—Defence* (PBS). Prepared in 2001, the Defence Plan is the first such plan. It aims to make clear the relationships between the Government’s five strategic objectives, the Government’s Defence outcome, Defence’s outputs and the four strategic tasks the Government has set for Defence.<sup>15</sup>

**2.16** The PBS state ‘the next iteration of the plan, Defence Plan 2002–12, will be prepared by October 2001 so that during the 2002–03 Budget process, whole-of-Defence resource allocation will clearly be in line with the Government’s strategic direction.’ At the completion of audit fieldwork (February 2002), the Defence Plan 2002–12 was not available.

**2.17** ID’s predecessor, DEO, was formed in 1997 to enable (and encourage) estate management and planning ‘effectively linked into overall defence strategic planning’.<sup>16</sup> This was particularly relevant given the lead times involved in defining and developing the estate (property and infrastructure) requirements needed to

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<sup>13</sup> Defence letter to ANAO in response to Discussion Papers, 10 April 2002.

<sup>14</sup> Defence properties for sale or possible sale are listed in the answer to Parliamentary Question No.136 at HR Hansard 14 May 2002 P2040 and P2041.

<sup>15</sup> *Defence Plan* (as at December 2001).

<sup>16</sup> *Future Directions for the Management of Australia’s Defence, Addendum to the Report of the Defence Efficiency Review: Secretariat Papers*, March 1997, p. 236.

meet Defence's emerging strategic and operational needs. However, the Defence Plan makes minimal reference to estate considerations in higher-level planning.

## Defence Financial and Management Plan

**2.18** The *Defence Financial and Management Plan 2001–2011*<sup>17</sup> stated that it was the first such plan and sought the Government's approval of funding levels for the progressive implementation of the Defence White Paper. The Plan includes a short section on the Capital Facilities Program (the Green Book) and states that the Defence estate was not considered in the Defence White Paper process.

**2.19** The Plan summarises expected spending on new facilities projects but does not refer to total estate considerations or link them to overall Defence strategic planning. It provides no guidance on the management of the property portfolio. The ANAO accepts that the present lack of readily available information on the estate contributes to the difficulties of linking estate requirements to strategic planning.

**2.20** In the *Portfolio Budget Statements 2002–03—Defence Portfolio*, Defence acknowledges that it faces a number of key areas of risk and emerging priorities which must be monitored and addressed if it is to deliver the performance expected of it by the Government. Defence states that these areas include the complexity of managing and maintaining Defence's extensive spread of bases and properties to meet capability priorities; efficiently use available resources; and provide for the needs of Defence personnel.<sup>18</sup>

## Strategic Plan for the Defence Estate

**2.21** The Defence Efficiency Review report (1997) commented that 'stronger links are needed between strategic guidance, capability analysis, preparedness, operational planning and the facilities planning process'.<sup>19</sup> A Strategic Plan for the Defence Estate (SPDE) was subsequently developed after extensive consultation with all Groups in Defence and endorsed by the Defence Executive in December 1998. In 1999 the SPDE was 'published' as a planning document.

**2.22** The SPDE was to provide a Defence Portfolio endorsed strategic master plan to guide the short, medium and longer-term development of the Defence estate over the next 20 to 30 years. It was also to provide a broad strategic framework for consideration of Defence estate issues.

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<sup>17</sup> *Defence Financial and Management Plan 2001–2011*, undated, apparently early 2001. Copy provided by I-G Division to ANAO in February 2002.

<sup>18</sup> *Portfolio Budget Statements 2002–03, Defence Portfolio (Department of Defence and the Defence Housing Authority)*, p. 5.

<sup>19</sup> *Future Directions for the Management of Australia's Defence, Addendum to the Report of the Defence Efficiency Review: Secretariat Papers*, March 1997, p. 220.

2.23 Chapter 2 of the SPDE provides that the following key criteria are to be considered in any rationalisation and consolidation of the Defence estate:

- contribution to capability;
- utilisation and relevance;
- vulnerability;
- national support;
- extent to which personnel requirements are met;
- community impact and pressures; and
- cost and affordability.

2.24 Management of the estate in accordance with these criteria requires reliable communication mechanisms and supporting information systems. There is currently little firm information on the contribution that individual properties make to capability, or on their utilisation and relevance. No system or management area captures all data on operating costs of the estate required in assessing the cost and affordability of a particular property, or the total estate. There was little evidence that the criteria are applied, or even considered, in the day-to-day management of the estate. Dissemination of the SPDE as a planning document has been ad hoc.

2.25 The latest draft edition of the SPDE does not contain any detailed information regarding the day-to-day management of either the owned or leased property portfolio. The data regarding the breakdown of owned and leased space and utilisation rates included in the 1999 published edition of the SPDE are not to be updated as the information is not readily available.

2.26 The SPDE is being reviewed to reflect the changes to estate requirements as a result of the recent Defence Renewal Agenda. The Agenda is having an impact on the business culture and resource allocations in Defence, with a focus on clear management, corporate responsibility and improved accountability. The concept of Customer Service Agreements is a specific part of the model and affects the way forward for the SPDE.

## **Master planning and siting approval**

2.27 Master planning is the process by which real estate is reserved to allow for the optimal long-term siting of activities on a Defence establishment. Conducted in ID, master planning aims to provide the link between the facilities required to fulfil the roles identified by strategic guidance and the facilities that actually exist on that particular Defence establishment.

**2.28** A Master Plan documents the future requirements and layout of an establishment. As a land use plan, it endeavours to provide appropriate areas of land for long-term strategic, operational and functional requirements when the need arises. A Master Plan takes into consideration existing and proposed facilities and provides a rationale for orderly and logical development of the establishment's infrastructure without compromising existing operations.

**2.29** Master Plans are to be reviewed every five to 10 years. Major changes in an establishment's roles and responsibilities, the introduction of a significant new capability or the delivery of a major facilities project, could initiate an early review of the relevant Master Plan.

**2.30** ID's Capital Infrastructure Planning Section manages master planning and regional property planning and is the initial point of contact for redevelopment proposals. It also processes siting approvals and facilities usage requests. The ANAO was advised that there are Master Plans for 25 major bases across Australia. Of these, 13 are available electronically by staff who have the appropriate software.

**2.31** The Regional Infrastructure Centres (RICs) are to consult the Section on all issues relating to master planning and siting approvals. Some of the RICs, however, still have their own staff undertaking this role. Where this occurs, it is important that the different offices closely communicate to minimise any duplication and inconsistencies.

**2.32** When a Master Plan is reviewed, detailed studies are undertaken on the establishment as part of the Regional Considerations and Existing Infrastructure (RCEI) section of the Plan. Location of existing buildings and their current and potential use are considered. The RCEI section also includes a description of the history, current roles and activities performed at the establishment. Consultants are often employed to gather this information, as it is not readily available.

**2.33** Once this updated Master Plan information is obtained, it resides with ID's Capital Infrastructure Planning Section. Other ID staff have little knowledge of this detailed information partly because the specialised software required limits access.

## **Need for data on property usage and cost**

**2.34** *The Commonwealth Property Principles* and the joint Defence and Finance review call for disclosure of data on the costs of owning and operating property, in the interests of accountability and decision-making. The Strategic Plan for the Defence Estate also indicates a need for data on property costs and usage for management purposes.

**2.35** The need to capture data on Defence property maintenance costs (part of total property costs), and attribute it to Defence outputs, was highlighted in the ANAO's 2000 report on the facilities operations program.<sup>20</sup> At the time, Defence agreed in principle to the recommendation where it was cost effective to do so. The Joint Committee of Public Accounts and Audit reviewed the audit and commented:

Defence told the Committee that the comprehensive maintenance contracts will allow DEO to identify costs down to the building level on a basis which will allow it to attribute directly the costs of maintaining all of the assets of the estate.<sup>21</sup>

**2.36** The ANAO notes that comprehensive maintenance contracts may enable capture of cost data but, without specific data on the facility occupants and the Output they support, the costs are not necessarily attributed to the correct Output. These contracts capture the maintenance and some construction costs of the estate rather than the full costs of operating and owning the properties. Property cost data collection issues and information systems are considered later in Chapter 5.

**2.37** Responsibility for various aspects of property management is spread among different areas of ID, and the total property costs are not collated. Data in Defence's annual report indicates that the cost of operating the Defence estate in 2000–01 amounted to \$1.9 billion (mainly comprising Capital Use Charge attributable to the ownership of property.)<sup>22</sup> This total represents 10 per cent of total Defence revenue in that year. It also represents more than 10 per cent of the gross or net value of the Defence estate—see paragraph 1.2. Costs of that magnitude should be taken into account in overall Defence property and capability management.

**2.38** The ANAO considers that readily accessible data on the usage and operating costs of the Defence estate, and its constituent parts, would assist in Defence strategic and estate planning; benchmarking against industry standards; deciding whether to contract out particular property management functions; and assessing efficiencies associated with the ongoing rationalisation and consolidation of the estate. Usage and cost data will also be needed when Customer Service Agreements are introduced as part of Defence's customer-supplier model. It would also assist in monitoring life-cycle costs of individual properties and in full costing of Defence outputs and capabilities.

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<sup>20</sup> ANAO Audit Report No.26 2000–2001 *Defence Estate Facilities Operations*, Recommendation No.1, p. 30.

<sup>21</sup> Joint Committee of Public Accounts and Audit, *Report 385*, August 2001, Canberra, p. 56.

<sup>22</sup> \$1.9 billion consists of Capital Use Charge (CUC) \$1.2 billion; Facilities Operations Program \$297 million; depreciation/amortisation charges on buildings \$285 million; utilities \$112 million; and lease costs \$30 million. (Figures derived from *Defence Annual Report 2000–01*, except for lease costs data from CSIG. For CUC estimate, see paragraph 3.24 below. Depreciation/amortisation charge on infrastructure assets was not readily available.)

## Recommendation No.1

2.39 The ANAO recommends that Defence collate data on the full cost of owning and operating the Defence property portfolio, and on actual usage of properties, to assist in Defence estate planning, benchmarking and management, and to enhance accountability.

### *Defence response*

2.40 Agreed in principle, noting that the necessary systems to capture the data will take some time to develop, but that they will be critical in supporting through-life estate planning and management.

## 3. Defence Property Management

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*This chapter discusses organisational arrangements and corporate documentation for Defence property management, and issues concerning Defence estate budgets, cost attribution and property revaluation.*

**3.1** Defence property management is one of numerous functions conducted by Defence's Corporate Services and Infrastructure Group (CSIG)—see paragraph 1.5. Property management is therefore conducted in the context of the CSIG Business Model.

### CSIG Business Model

**3.2** Creation of CSIG in July 2001 was expected to yield administrative and overhead savings and to increase effectiveness. CSIG was to do business according to the following principles:

- a customer focus;
- one point of contact for customers;
- integration of planning, budgeting and reporting processes; and
- maintenance of strong product lines (infrastructure, information systems and service delivery) to underpin the single point of contact with the customer.

**3.3** The primary goal for CSIG was to develop a model designed to meet clients' expressed concerns for a single point of contact for CSIG matters. A business model, then known as the Corporate Services Group Business Model, was established in December 2000 to do this. By December 2001, however, concerns about service delivery prompted CSIG to arrange for a senior officer to review the Business Model in consultation with CSIG staff. The review was completed in February 2002. Its conclusions were as follows.

3.1.1 The openness and acceptance of the need for change by the Executive which catalysed this review demonstrates the CSIG is now well positioned at the Leadership level to move towards a single Culture committed to the delivery of CSIG products and services to clients. This 'one voice' from the Senior Leaders should now be inculcated throughout all leadership levels in the form of a single CSIG culture.

3.2.1 The complexity of CSIG's service delivery should never be underestimated. It strives to deliver in a cost effective manner, through its own staff and contractors, a range of products and services at both a national and regional level to meet the diverse needs of Regionally-based, Command and Portfolio clients. Based on the

feedback from those consulted, there is a range of improvements that can be made at Regional level.

3.3.1 Feedback from those consulted indicated that enhanced service delivery in the Regions is *not sustainable in the long term* without realignment of, and improvement in, the support provided from the National Office. The form of this support includes:

- (a) Clearly defined planning processes;
- (b) A single line of reporting; and
- (c) Clearly defined products with associated performance criteria.

3.4.1 At present there is confusion between the roles of the product developers (i.e. technical control) and the service deliverers. In order to provide a clear focus on service delivery, CSIG require an entity whose primary focus is on the delivery of products and services in accordance with prescribed standards.

3.5.1 During the course of the Review a number of important people issues were identified. Feedback suggested that:

- (a) many staff are working excessive hours (with accrued flexi-time leave amounting to a hundred hours not uncommon);
- (b) the roles and responsibilities of staff lack clarity;
- (c) few staff have clear and current Position Descriptions; and
- (d) there are no/few training programs to skill people for their new role.

3.6.1 From the clients' perspective, CSIG does not effectively present itself as a single entity. It has multiple web sites, a myriad of versions of forms designed to achieve the same or similar outcomes, different processes between Regions for the same request. There are no 'corporate' standards for the physical appearance of the facilities, staff dress codes and client correspondence. Language and terminology varies between divisions and sometimes across Regions and the description of CSIG services relates more to the product lines than to a united CSIG.<sup>23</sup>

**3.4** To remedy the situation and assist in applying the principles of the Business Model, the report made recommendations, with a timetable for action. In response to the report, the then Deputy Secretary Corporate Services commented to CSIG as follows:

Your input to the review, and the feedback we've received from both you [CSIG staff] and our customers indicate that, while we have come a long way, in many ways we still appear and behave as three very separate organisations. This prevents us from providing the quality of service that we aspire to. ...

We are now in a position to take the next step in our journey—to improve the integration of the three Divisions and to make it easier for our customers to deal with CSIG at the base and regional levels.<sup>24</sup>

<sup>23</sup> CSIG, *Review of CSIG Business Model for the Delivery of Service to CSIG Clients—Report*, February 2002.

<sup>24</sup> From e-mail message from Deputy Secretary Corporate Services to CSIG staff 13 February 2002.

3.5 A small team including regional representatives has been established to develop the next step, which is to commence testing in two of the 12 CSIG regional on 1 July 2002. The ANAO understands that the team comprises mainly Service Delivery Division (SDD) staff. In order to have a coordinated, single approach, the ANAO considers there should be adequate ID representation in this process, particularly as ID products form a considerable part of the CSIG budget.

3.6 Discussions with Defence in April 2002, at the close of the audit, indicated that senior executives in CSIG and ID were aware of the need to make changes. They had proposals in hand for the next step in implementing the Business Model and to improve the integration of the three Divisions. A major reorganisation would aim to deliver services in a manner seen by clients as seamless, consistent across regions and responsive to their changing needs.

## Infrastructure Division

3.7 Defence Estate Organisation (DEO) became Infrastructure Division (ID), in CSIG, in 2001. At the time, it was identified that, although decisions affecting use, occupancy and maintenance of these 'assets' affected the whole Defence organisation, they remained a specific infrastructure management responsibility. As such, ID advice was to be sought on all matters concerning the use or possible use of the Defence estate. ID manages property and other estate functions provided by Defence itself. SDD manages property functions, such as electricity and water, provided by local authorities and other external providers, and services, such as cleaning and grounds maintenance contractors. This audit focused on ID's property management functions, with consideration of all the costs associated with the use of the estate.

3.8 The emphasis on ID's corporate approach was amended recently. ID is now to be reactive to ADF force disposition planning while being pro-active to external issues such as regional planning, community interests and market conditions. ID is to be responsible for meeting the ADF's requirements concerning the shape, size, value, disposition and use of the estate and for making decisions on investment, divestment, re-investment and operating costs.<sup>25</sup>

3.9 ID develops, recommends, implements and reviews facilities and property policies, plans, programs, procedures and standards including capital works, property acquisition and disposal, repairs and maintenance and environmental policy and management. ID's central office, located in Canberra, consists of three branches:

- Infrastructure, Planning & Environment (IPE) Branch;

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<sup>25</sup> *Doing Business with Defence for Construction and Estate Management*, January 2002, < [www.defence.gov.au/id](http://www.defence.gov.au/id) >

- Capital Infrastructure (CI) Branch; and
- Estate Management (EM) Branch.

3.10 ID's central office is assisted by 12 Regional Infrastructure Centres (RICs) around Australia. Where possible, the RICs are located with the major Defence clients and other regional CSIG staff. In many regions, this collocation is still in the planning phase. As ID only had nine regional estate centres prior to the CSIG formation, three sub-regional offices were created within existing staff arrangements to match the Service Delivery Division regional boundaries. At the time of audit, ID had only nine regional 'Managers–Infrastructure' (MIs).

### Infrastructure Division corporate documents

3.11 Formed in 1997, the DEO developed and promulgated a corporate plan in 1998. The plan outlined the mission and values of the organisation and explained the organisation, key developments and issues. DEO also developed lower-level business plans to support its corporate direction. At the time of audit, no endorsed ID corporate or business plan was available for review.

3.12 The ANAO also noted that ID lacks an endorsed risk management plan. The *Defence Risk Management Plan 2002* states 'formal risk management is no longer discretionary and is now considered an essential component of public sector management and sound corporate governance.'<sup>26</sup> That Plan represents a strategic approach to risk management in Defence and is to be supplemented by *Guidelines to Managing Risk in Defence* to assist in giving effect to the approach. It would be useful for ID to identify and assess its business risks, including those relating to property management, in the manner indicated in the Defence Risk Management Plan.

### Property management

3.13 The Directorate of Property Services (DPS) in ID's Estate Management Branch is the central coordination point for Defence property service activities. These include activities relating to Native Title; mining and non-Defence use of Defence property; and unexploded ordnance on non-Defence land. The DPS is responsible for acquiring and leasing property for Defence and managing the National Property Services Contract (see Chapter 6). The ANAO was advised that no one area in ID is tasked with overall Defence property management.

3.14 The DPS deals with issues that affect the estate at the national level. Estate Planning staff and Property Officers in the RICs manage day-to-day property issues. Any technical guidance and instruction required is sought from DPS.

<sup>26</sup> *Defence Risk Management Plan 2002*, March 2002, Foreword by the Secretary of the Department of Defence and the Chief of the Defence Force.

**3.15** DPS indicated that MIs are responsible for managing the owned estate, including space allocation and estate utilisation. DPS has no visibility of these specific issues (except in the ACT) and does not view this as necessary for its work. Fieldwork indicated that the regional offices were not specifically aware of this responsibility.

**3.16** With the formation of CSIG, discussed in paragraph 1.5, the previous roles and responsibilities of the three Divisions have become blurred. For example, when DEO and Defence Corporate Services (DCS) were formed, a matrix dividing estate management responsibilities was agreed and implemented. The task of space allocation was formerly DCS's responsibility yet advice provided to the ANAO during the audit was contradictory on this matter. With the lack of ownership and responsibility, evidence indicates that, corporately, space allocation and therefore management of property utilisation has been overlooked.

**3.17** ID has developed minimal policy and procedural guidance. A Statement of Requirement—Policy Development, provided by DPS to a consultant in December 2001, commented as follows:

The following policy documents are already published or are in draft format and need to be reviewed/finalised: non-Defence use of Defence Facilities; UXO [unexploded ordnance] Commonwealth policy; UXO panel; and short term hire and staging areas.

Subject matter that require the development of policy documentation include, but are not limited to:

- expenditure leases;
- revenue leases;
- overseas leases;
- property acquisition;
- Lands Acquisition Act;
- Native Title;
- mining on Defence land;
- Defence Housing properties;
- rifle ranges;
- salvage of military relics;
- short term hire agreements;
- general licences;
- rural and grazing licences; and
- telecommunication licences.

**3.18** Reflecting the findings of the CSIG Business Model review, the ANAO found, in the absence of policy and procedural guidance, a lack of clarity in the requirements of property management in ID and elsewhere in Defence. Management is essentially reactive to clients' individual needs, and lacks a proactive approach to overall Defence needs.

**3.19** As a result of minimal guidance to the RICs, property management varies significantly. One RIC visited by the audit team had developed a set of detailed procedural guidance to help give a consistent approach to regular property issues that it deals with. Procedures in other regions were more ad hoc and reactive in their approach to issues.

**3.20** ID engaged consultants in December 2001 to review and develop policy documentation (based on the Statement of Requirement referred to at paragraph 3.17). It was expected that, by March 2002, subject matters that require the development of detailed policy and procedural guidance will be clarified sufficiently to enable the work to commence. Customer Service Agreements, when implemented, should also assist in defining property management requirements (see Chapter 4).

## Budget

**3.21** With the introduction of accrual accounting in Defence on 1 July 1999, a new financial management framework was implemented. A major focus of this framework was the attribution of costs to Defence capability outputs that support the 'Defence outcome' (see paragraph 1.1) purchased from Defence on behalf of the Australian community. Defence outputs (six in number) are set out in the *Portfolio Budget Statements 2001–02 – Defence*.

**3.22** A key initiative under the Commonwealth's accrual budgeting framework was the introduction of the Capital Use Charge (CUC) from 1999–2000. The CUC rate is set annually by Government. For 2001–02 the rate was reduced from 12 to 11 per cent of net assets.<sup>27</sup>

**3.23** Funding for the CUC is based on the department's opening equity<sup>28</sup> and is included in agency's departmental output appropriations. The CUC is an equity measure representing the cost of capital employed by the agency. The aim of the CUC is to improve Government resources allocation by ensuring that the full cost of activities is shown and the cost of capital is reflected in the pricing structures of outputs.

**3.24** The CUC payable by Defence in respect of 2000–01 was \$5 billion.<sup>29</sup> Defence has stated that the objective of the CUC is to better reflect the true costs of outputs and to encourage good asset management practices.<sup>30</sup> The CUC for Defence is reported at the 'corporate' level in the annual financial statements. The CUC is not linked to individual assets or the users of these assets. As a result, the incentive for, and therefore impact on, asset management relating to property holdings has been minimal. The CUC has provided minimal incentive to dispose of under-utilised or surplus assets, as there is no visibility of the impact of the CUC on such assets. The ANAO estimates that the portion of total CUC payable

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<sup>27</sup> See guidance notes on CUC at Department of Finance and Administration website <[http://www.finance.gov.au/budgetgroup/other\\_guidance\\_notes/capital\\_use\\_charge.html](http://www.finance.gov.au/budgetgroup/other_guidance_notes/capital_use_charge.html)>

<sup>28</sup> *Defence Annual Report 2000–01*, financial statements, pp. 152 and 190.

<sup>29</sup> *Defence Annual Report 2000–01*, financial statements, note 22, p. 187.

<sup>30</sup> *Portfolio Budget Statements 2000–01, Defence Portfolio*, p. vii.

by Defence attributable to the ownership of land, buildings and infrastructure assets amounted to \$1.2–1.3 billion in 2000–01.

**3.25** The Department of Finance and Administration noted that agencies are motivated by a number of incentives to dispose of under-utilised or surplus assets. For example, *The Commonwealth Property Principles* and Government policies on asset management are likely to have a direct impact on an agency's incentives to appropriately manage these assets.<sup>31</sup> Furthermore, under the *Financial Management and Accountability Act 1997*, Chief Executives are responsible for the efficient, effective and ethical management of resources under their control. In Finance's opinion, the discharge of this responsibility requires consideration of all applicable policies, including in relation to asset holdings, and this should occur as part of ongoing management.<sup>32</sup>

### **CSIG and ID budget information**

**3.26** The ANAO sought information about CSIG's and ID's budgets for 2001–02 but this was not available at the time of preparing this report. As mentioned in paragraph 2.36, the Defence annual report indicated that the cost of operating the Defence estate in 2000–01 amounted to \$1.9 billion, which represents 10 per cent of total Defence revenue in that year.

### **Cost attribution**

**3.27** Under Defence's accrual accounting framework, ID is funded for its activities on the basis of an Operating Budget and a Capital Budget. The Operating Budget funds the net cost of doing business; the Capital Budget funds capital projects. The Operating Budget is managed on an accrual basis; that is, the budget is consumed once a liability is recorded, not when the account is paid. The Capital Budget is managed on a cash basis.

**3.28** To facilitate outcome/output management and reporting in ID, cost data are captured against a cost centre structure that records transactions for the 200 major establishments against which the majority of the Operating Budget<sup>33</sup> is spent. As property management related costs are attributed and reported against the six Defence outputs, there is no departmental visibility of the overall costs associated with these activities.

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<sup>31</sup> See ANAO comments on *The Commonwealth Property Principles* in relation to Defence at paragraphs 2.6 and 2.7.

<sup>32</sup> Department of Finance and Administration advice to the ANAO dated 16 May 2002.

<sup>33</sup> The Operating Budget for ID includes employee entitlements, facilities operations costs, travel charges, operating leases, incidentals, net loss from asset sales, depreciation and the Capital Use Charge. (DEMG Book 8 Part 6, 19 December 2001.)

**3.29** To attribute ID expenditure to outputs, Defence's Output Managers have attributed the activities of the 200 properties to sub-outputs on a percentage basis. A weighted average is derived from the data and subsequently applied to the cost centres that capture all other operating costs. This is known as the ID 'overhead rule'.

**3.30** This arbitrary cost attribution process has been found necessary in the absence of firm data on the Output group occupying, and number of personnel in, each Defence building or facility. This issue is further discussed in Chapter 4.

## Revaluation of the estate

**3.31** Section 6(3) of the 1998–99 Finance Minister's Orders for FMA agencies states:

Property, plant and equipment must be revalued in accordance with the deprival method of valuation by no later than 1 July 1999, then revalued progressively over a three-year period on that basis.

**3.32** The Australian Valuation Office (AVO) was engaged to revalue assets managed by ID valued at \$250 000 or more over a three-year revaluation cycle: 1999–2000 to 2001–02.<sup>34</sup> As part of this process, AVO provides a short report on each of the assets revalued each year certifying the accuracy and correctness of the valuations and changes. The reports include:

the property identification number; property description; address/location; short statement as to accuracy/correctness of gross valuations as at 30 June of applicable financial year; signatures, names and qualifications of valuers; date of report; and any particular observations.

**3.33** Site visits are often required for these revaluations. At times, title searches are also undertaken to ensure the areas being revalued are Defence property. As the revaluations are undertaken as part of the financial regulatory framework, current reports (both electronic and hard copy) reside with CSIG's People, Planning and Finance Branch (Asset Policy and Accounting Section). This information would be useful in the day-to-day management of the estate but, outside the Asset Policy and Accounting Section, few ID staff are aware of the AVO work. DPS holds the hard copies of more historical AVO reports.

## Conclusion

**3.34** In 1997, it was identified that management of the estate should be a single, coordinated task to be undertaken by DEO. However, at the time, related property management roles, such as management of cleaning contracts and

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<sup>34</sup> The contract has an optional extension clause to include the following three-year revaluation period. At the time of audit fieldwork, the contract extension was under discussion.

utilities suppliers, were split between DEO and Corporate Services. With the split in roles, the 'owner' of the estate does not have visibility of the complete estate and its needs.

**3.35** Property management is now one of the functions undertaken in Infrastructure Division in CSIG. A recent internal review of the CSIG Business Model indicates that enhanced service delivery in the Regions is not sustainable in the long term without better support provided from the National Office by means of clear planning processes; a single line of reporting; and clearly defined products with associated performance criteria. Confusion between product developers and service deliverers could be avoided by a clear focus on service delivery, which itself needs to accord with prescribed standards. The review also indicated a need for staff to have clarity in their roles and responsibilities; appropriate training programs for their new role; consistent processes between Regions; and 'corporate' standards for the physical appearance of the facilities.

**3.36** Proposals are being considered to remedy the situation identified in that review. In doing so, adequate attention needs to be given to the issues as they relate to delivery of property management services across Infrastructure Division. The team appointed to implement action on the review should be representative of the three Divisions involved and the services they deliver.

**3.37** Within ID there is only minimal corporate documentation to guide staff on the delivery of property management services. As a result, there are wide variations in property service delivery to clients around Australia and the level of management information available. At the time of audit, DPS were addressing this lack of property management guidance.

**3.38** Each year, property management related activities cost Defence in the order of \$1.9 billion. This includes the Capital Use Charge relating to the ownership of property assets, which is yet to take effect as a means of promoting efficient asset management. The ANAO found that there is no departmental visibility of the extent of these costs, as they are attributed across the six Defence outputs. There is no system that draws this cost data together or captures all the information required for estate management. The introduction of Customer Service Agreements will necessitate Defence addressing these issues.

**3.39** Discussions with Defence in April 2002, at the close of the audit, indicated that new senior executives in CSIG and ID were aware of the need to make changes. They had proposals in hand for the next step in implementing the Business Model and to improve the integration of the three Divisions. A major reorganisation would aim to deliver services in a manner seen by clients as seamless, consistent across regions and responsive to their changing needs.

## 4. Customer Service Agreements

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*This chapter examines property management aspects of Defence's customer-supplier model and issues concerning facilities to meet Defence capability requirements.*

### Defence's customer-supplier model

4.1 Since the Defence Efficiency Review (DER) in 1997, proposals for introducing a system of internal rents on Defence properties have been on the agenda in Defence. DER considered that internal rents would help change the culture of facilities being considered as a 'free good' and not representative of the full costs of ownership. The concept was agreed in principle in 1998 but not implemented, because it was considered that the move to accrual accounting and the output/outcome framework would achieve the culture change being sought.

4.2 The concept of internal rents has been further delayed because of the proposed introduction of purchaser-provider (or customer-supplier) arrangements between the Output Executives (e.g. Army) and the Enabling Executives (e.g. CSIG) as part of the Defence Renewal Agenda as mentioned earlier in this report.

4.3 A key principle of the latest Defence business model is that those who are accountable for delivering results will be assigned the resources necessary to achieve those results, and will be held accountable for the effective use of those resources. Last year's PBS stated that 'the priorities in 2000–01 are to ... introduce clearer purchaser-provider relationships to ensure efficient delivery of internal services'.<sup>35</sup>

4.4 In the latest Defence annual report, the Secretary of the Department and the Chief of the Defence Force commented as follows:

Preparations began in 2000–01 for implementation of Defence's 'customer-supplier agreements' between output and enabling executives. For the first time, the output executives were provided with the price of their respective outputs and were directed by us to strike internal business relationships as purchaser of goods and services from the enabling Groups.

The charters state the results to be achieved by individuals, in general terms. The customer-supplier agreements specify the levels of performance to be achieved, at a price.

Further implementation of the [business] model will take place during 2001–02, at the end of which we anticipate that the alignment and accountability phases of

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<sup>35</sup> *Portfolio Budget Statements 2000–01—Defence*, p. 7.

the renewal agenda will largely have been completed. A major challenge will be to ensure that decision makers can be properly held to account—a difficult task in the absence of good quality management information.<sup>36</sup>

#### 4.5 The annual report also stated that:

An internal customer-supplier model was developed during the year as a key plank of integrated performance management arrangements to be implemented across Defence from 2001–02. Its objective is to better inform Defence’s Groups in supporting the Secretary and the Chief of the Defence Force in delivering the outputs and financial performance expected of Defence by the Government. The customer-supplier model is focused on accountability for customer-driven performance levels and the earning of resourcing for service delivery.<sup>37</sup>

4.6 Several Customer Service Agreements (CSAs) have been made but not yet implemented. CSAs formalise the responsibilities for provision of product and service delivery at an agreed price. Performance reporting to the customer is a key feature of the agreements. Table 1 lists the CSAs for 2001–02 that have been made between CSIG and individual Groups. (CSIG includes Infrastructure Division.) The CSAs are in the form of higher-level ‘head agreements’. CSIG was to have CSAs for 2001–02 with a further six Groups but it was decided not to proceed with these. Instead, staff focus has been directed to the development and improvement of CSAs for 2002–03.

**Table 1**  
**CSIG Customer Service Agreements for 2001–02, as at 7 January 2002**

Group (customer)	Date of agreement
Air Force	22 June 2001
Defence Science and Technology Organisation	6 August 2001
Inspector-General’s Division	6 August 2001
Army	25 September 2001
Defence Personnel Executive	17 October 2001
Defence Materiel Organisation	29 October 2001
Public Affairs and Corporate Communication	23 November 2001
DEPSEC Intelligence and Security	22 November 2001

Source: ASPPF in CSIG

<sup>36</sup> Department of Defence, *Defence Annual Report 2000–01*, 28 October 2001, pp. 7 and 8.

<sup>37</sup> Department of Defence, *Defence Annual Report 2000–01*, 28 October 2001, p. 246.

**4.7** CSAs are expected to bring about closer linkages between customer activity levels and the provision of corporate services and infrastructure support, in a timely, cost effective and efficient manner. They are also expected to result in savings in the medium to longer term.<sup>38</sup>

**4.8** CSAs set out standard ‘product lines’ and associated ‘products’ provided by the three Divisions of CSIG. ID provides the following three products:

- Estate Usage—described as space and facilities allocation;
- Corporate Estate Management—defined as estate strategic planning, environmental plans; and
- Estate Maintenance and Development—defined as fixed plant and equipment maintenance, reactive maintenance, planned works, environmental management, property management, property acquisition and disposal, heritage management.

**4.9** CSIG regional offices are yet to develop lower-level CSAs with key customers. Until these are agreed, it is difficult to quantify the services to be provided to customers in relation to property management. This is compounded by the lack of central office policy and procedural guidance to the regional offices on property management.

**4.10** In relation to the higher-level agreements, a minute by the then Defence Chief Finance Officer provided to the Defence Audit Committee in February 2002 stated:

While significant difficulties were encountered in the lack of accurate costings of internal activities/products, significant ground had been made in better understanding Defence’s non-financial performance requirements and the impact of internal business relationships.

... customer service agreements (between Services/Groups) have not been formalised but the drafts nevertheless provide a sound basis for all Services/Groups to continue to develop their performance levels.

Given the difficulties Defence still has in understanding (or even seeing) the costs of individual activities, Service/Group resource allocations continue to be based on the existing direct responsibilities of each Service/Group. ...many of the unresolved issues of responsibility between Service/Groups have hindered Defence’s performance for some time and their resolution will allow Defence to move forward more readily.<sup>39</sup>

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<sup>38</sup> *Defence Financial and Management Plan 2001–2011*, Annex p. 53.

<sup>39</sup> Defence CFO Minute 16/2002, February 2002.

**4.11** The Chief Finance Officer also indicated to the Defence Audit Committee that implementation of the Customer-Supplier Model has slipped from 2001–02 to 2002–03, as more work is needed on cost attributions that will form the basis for the CSA charges.

**4.12** This is part of the wider issue of costing and business systems in Defence. A former Minister for Defence, in a statement in 2000, referred to a review aimed at reforming Defence’s business systems to improve financial reporting and the audit process and enable Defence to understand and manage its costs, thereby allowing Defence to make good business decisions. He said that \$40 million was available for business systems reform.<sup>40</sup> Defence commented in its Annual Report that it had made progress in improving its management information systems but that the inordinate effort required to produce its 2000–01 financial statements highlighted the urgent need to dramatically improve those systems.<sup>41</sup>

## **CSIG–Army CSA**

**4.13** The ANAO reviewed CSIG’s CSA with Army, with particular reference to ID’s estate products. Annex C to the CSA defines the mandatory performance measures and reporting requirements against each product line and product. The only performance measure relating to ID products in the CSA concerned the Estate Maintenance and Development product line. The performance indicator for the property management service in this product line is ‘OH&S incidents’. It is unclear how this ‘measure’ contributes to good property management performance.

**4.14** The other two ID product lines (Estate Usage and Corporate Estate Management) combined represent 52 per cent of the CSIG product cost that would be charged to Army. No performance measures have been identified for these products.

**4.15** The pricing schedule at Annex D to the CSA provides a matrix breakdown for each product detailing the following criteria: the ‘main user’ of the product; the ‘initial basis for the charge’; the ‘unit to measure’; the ‘cost driver’; and the resulting ‘price/fee for service’.

**4.16** The Estate Usage product is defined as the building value per occupant. The cost drivers for the product are Capital Use Charge rate, depreciation and property value (based on building location, size, quality and age).

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<sup>40</sup> The Hon John Moore MP, Minister for Defence, 19 December 2000 MIN388/00 *Minister Announces Retirement from Parliament*, p. 4.

<sup>41</sup> Department of Defence, *Defence Annual Report 2000–01*, 28 October 2001, p. 17.

**4.17** An attachment to the CSA outlines the agreed product line costs and the associated cost driver. The product cost driver for Estate Usage is an 'Estate Location List' instead of the drivers defined in the CSA itself. The ANAO was advised that CSIG staff compiled the Estate Location List from various sources in the absence of a system that would provide the required occupancy data. The staff expect that the Defence Estate Management System (DEMS) will be able to provide the required information for this cost driver for next financial year's CSAs. At the time of ANAO fieldwork, however, DEMS did not have this capacity.

**4.18** The CSIG–Army CSA indicates that there has been minimal involvement of appropriate ID staff in its development. This is illustrated in the lack of performance measures identified with ID products and associated agreed 'units to measure' and 'cost drivers'.

**4.19** CSIG lacks a system to support the identified 'units to measure' or 'cost drivers' stated in the CSA. Numerous information systems, databases and spreadsheets capture some of the data required but corporate visibility is not readily available. Work is being done on DEMS to consolidate this data but the ANAO is not aware of any CSIG Executive decision to use DEMS for such a role. The CSA commits CSIG and Army to develop a suitable pricing model to replace the existing attribution system, with a focus on appropriate cost drivers, recognising regional and local pricing differences, over the next 12 months.

## Facilities for Defence capability requirements

**4.20** As mentioned in paragraph 4.7, CSAs are expected to bring about closer linkages between customer activity levels and the provision of corporate services and infrastructure support. In order for these linkages to be achieved, relevant CSIG staff need to be aware of the strategic issues faced by Defence's Output groups that will affect CSIG's ability to provide responsive, efficient customer service.

**4.21** The Strategic Plan for the Defence Estate (SPDE) defines capability in a Defence context as:

the power to achieve a desired operational effect in a nominated environment within a specified time, and to sustain that effect for a designated period.

Capability is delivered by systems that consist of the Fundamental Inputs to Capability: facilities, organisation, personnel, collective training, major systems, supplies, support, and command and management. From another perspective, capability is the combination of force structure and preparedness.<sup>42</sup>

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<sup>42</sup> Strategic Plan for the Defence Estate (2002 revised), paragraph 4.11.

**4.22** The facility needs of an identified new Defence capability usually require acquisition or construction of a new facility, usually by means of a 'medium' or 'major' works project arranged by Infrastructure Division. A medium project is expected to cost between \$250 000 and \$6 million; a major project is expected to cost more than \$6 million. For both medium and major projects, Defence has a formal staged committee process (normally extending over several years) for considering, analysing and approving the proposed works project; its priority in the works program; and its estimated costs and funding source.

**4.23** The approval process sometimes requires Defence to engage consultants to assess the current usage of the particular part of the Defence estate, since timely and accurate information of that kind is not readily available in Defence. A major project must also be submitted to the Parliamentary Standing Committee on Public Works Committee for approval. Medium and major approved projects are listed in Defence's 'Green Book'<sup>43</sup> and therefore visible. The works program amounts to more than \$300 million a year.

**4.24** For a revised Defence capability, the facilities requirement can usually be met by modification of an existing facility or acquisition or construction of a new facility. Generally, it is arranged as a 'minor' works project (expected to cost less than \$250 000) through ID's regional Facilities Operations (FACOPS) program. The arrangements to meet these facilities requirements, however, are less satisfactory than those for major works. FACOPS staff are often at a disadvantage because communication of the facilities requirement to ID and within ID on such issues is inadequate. By the time the facilities needs of a revised capability are made known to those responsible for implementing them, those needs have become immediate (e.g. to relocate a Defence unit, install demountable buildings or rent additional office space).<sup>44</sup>

**4.25** The funding source, too, is uncertain as the regional FACOPS bid process and allocation occurs the year prior to delivery, leaving funding for some unplanned tasks to be met by the (already-allocated) FACOPS budget. This means that some 'capital' items (new facilities for revised capabilities) are met from the FACOPS program, which is intended for property maintenance.<sup>45</sup> Information about facilities requirements for revised capabilities is not separately identified from the other minor capital works in the FACOPS program.

**4.26** The development and 'fine-tuning' of the CSA process provides the opportunity to identify the roles and responsibilities of the parties involved in

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<sup>43</sup> Defence, *Capital Facilities "Green Book" 2001–2004*, April 2001, Canberra.

<sup>44</sup> ID's Regional Infrastructure Centre, Northern Territory, receives numerous facilities requests at short notice due to the operational tempo in the region. It responds to such requests with its own standardised procedure for addressing them systematically and ensuring that clients justify the request. It also maintains information on space available at NT bases so that such requests can be considered quickly.

<sup>45</sup> Less than 5 per cent of the 2001–02 FACOPS budget is presently identified for 'capital' works.

works facilities for revised Defence capabilities. The ANAO suggests that, in that process, ID seek to clarify and formalise the ad hoc communication and funding issues involved in present arrangements for providing facilities for revised capabilities.

## Conclusion

**4.27** CSIG staff are progressively developing CSAs with the Output and other Enabling Executives throughout the department. Defence recognises that the CSA implementation process has been challenging given the difficulties it has in understanding and/or even identifying the costs of individual activities.

**4.28** ANAO's analysis of the signed CSIG–Army CSA indicates that there has been minimal involvement of appropriate ID staff in its development. This is further indicated by the defined 'units to measure' and 'cost drivers', agreed between Army and CSIG, not currently captured by any one Defence IT system.

**4.29** The CSA process should provide the mechanisms to enable both new and revised capability requirements to be addressed. Improved communication, particularly regarding revised capability, is required to ensure such requirements are identified in a timely manner.

## Recommendation No.2

**4.30** The ANAO recommends that Defence ensure that, in the Customer Service Agreements between CSIG and its 'customers':

- a) the property service elements provide for 'units to measure' and 'cost drivers' that are supported by reliable and current data on property costs and usage; and
- b) provision is made for adequate planning and communication of facilities needed to satisfy revised capability requirements.

### *Defence response*

**4.31** Defence provided the following response to Recommendation No.2:

- a) Agreed in principle. Noting that the supportable 'units to measure' and 'cost drivers' in Customer Service Agreements (CSAs) will take some time to develop, but will be addressed in the product costing work currently being done within CSIG in the lead-up to full CSA implementation.
- b) Agreed. This will be addressed through the implementation of the Customer Supplier Model (CSM), which will see the Output Executives (in particular) developing Organisational Performance Agreements with the Secretary of the Department and the Chief of Defence Force.

## 5. Property Information

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*This chapter discusses requirements for disclosure of property information and Defence databases for collecting that information.*

### Disclosure of property information

5.1 The Senate Finance and Public Administration References Committee reviewed property management in the Australian Public Service in 1995. It reported that, as a result of the decentralisation of the Department of Administrative Services' central agency function and the devolution of property management functions to individual agencies in 1989, there was no single central body responsible for maintaining a register of the Commonwealth estate.<sup>46</sup> It was surprised to learn that there was no consolidated register of the Commonwealth estate and was keen to see steps taken to rectify this problem.<sup>47</sup>

5.2 In regards to the Department of Defence, the Committee stated:

... the Committee regards it as particularly appropriate for the Department of Defence, whose assets are so substantial, to include a register of its property holdings in its annual report, or at least have this level of information available on request.

The Committee went on to recommend that:

... government departments and agencies provide to the Parliament on an annual basis in annual reports, a breakdown of all office space occupied, whether or not it is owned or leased, the occupancy rates and population density of that space and the costs attributable to that space.<sup>48</sup>

5.3 The Government, in 1998, responded to the report as follows:

The Government recently announced its intention to establish a strategic alliance with one or more private sector providers to manage the Commonwealth's non-Defence property portfolio. In light of this decision and the substantial progress already made towards improving the efficiency and effectiveness of the property portfolio the Government does not propose to take up the Committee's recommendations at this time.<sup>49</sup>

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<sup>46</sup> It is of interest to note that the NSW Auditor-General recently reported that the NSW Government does not have a comprehensive record of all its property assets despite this having been required by NSW law since 1988. (NSW Auditor-General *Department of Information Technology and Management, Government Property Register*, 31 January 2001, Sydney.)

<sup>47</sup> Senate Finance and Public Administration References Committee, *Property Management in the Australian Public Service*, June 1995, paragraphs 2.1 and 2.17.

<sup>48</sup> *ibid*, p. 6.

<sup>49</sup> Government Responses to Parliamentary Committee Reports, Response to the Schedule Tabled by the Deputy President of the Senate on 10 December 1998. Circulated by the Leader of the Government in the Senate, Senator the Hon Robert Hill, 29 June 1999, p. 4.

5.4 The Government's *Requirements for Department Annual Reports* specified, for several years, that the following information should be disclosed:

- overall office usage by program and program element, expressed in terms of rental charges, including outgoings (expressed in dollar terms per square metre); and square metres of office space for each occupant;
- non-office space giving details, for each program and program element, of the properties (number, type of property etc) and rents paid. Any comments by Australian Estate Management on departmental or program property usage also should be incorporated in the report;
- dead rent relating to each program and program element, detailing the extent and cost of space not occupied for more than 6 months and the reasons for each such case (eg disposal action pending, termination date of lease); and
- valuations relating to the properties of each program or program element which are exempt from a rent or capital use charge, identifying each such property, its asset valuation and the basis for that valuation.<sup>50</sup>

5.5 Defence's Annual Reports from 1995–96 to 1997–98 stated that property usage information was available on request. The information for those years is no longer readily available. Current information is not available. The Strategic Plan for the Defence Estate (1999 version) set out property usage information as at 30 June 1998, but updates of the information are not readily available.

5.6 The *Requirements for Departmental Annual Reports* were amended in May 1999 in accordance with a Government decision to streamline annual reports, and the requirement for information on requests was removed. There is now no requirement for departments to report annually on property usage or to have the information available.

5.7 As indicated in Chapter 2, *The Commonwealth Property Principles* state that the costs of property use should be fully reported, but this is not enforced. Defence does not report this information.

## Property information in Defence

5.8 Defence does not have a corporately-recognised system for registering detailed information regarding its real property estate. This presents difficulties for strategic-level management and day-to-day property management. Various information systems are in use in Defence but at the time of audit there was no authoritative system used for recording the estate portfolio. Systems presently in use are summarised below.

<sup>50</sup> Department of the Prime Minister and Cabinet, *Requirements for Departmental Annual Reports*, Approved by the Joint Committee of Public Accounts under subsection 25(7) of the *Public Service Act 1992*, March 1994, updated 1998.

## *ROMAN*

**5.9** ROMAN (Resource and Output Management and Accounting Network) is the Defence-wide financial management system developed to support the financial management framework introduced in July 1999. ROMAN includes the official register for assets in Defence, and is the basis for the property values included in Defence's annual financial statements.

**5.10** Infrastructure Division (ID) has identified that the estate asset data in ROMAN is not used for estate management purposes and is prone to data integrity issues such as control, currency and reliability. The level of estate asset detail in ROMAN is insufficient to support CSIG estate management requirements. ROMAN data is used for accounting purposes rather than for management of the estate.

**5.11** The asset register data in ROMAN is accessible by few staff in CSIG, even in a read-only capacity. It is the responsibility of two CSIG staff to update the data after it is forwarded to them from other areas in ID.

## *DEMS-FM*

**5.12** Defence Estate Management System—Facilities Management (DEMS-FM) was developed as an electronic management system with the formation of DEO in 1997. It replaced the three incompatible systems used by the individual Services to manage the estate. Since the ANAO's performance audit of Defence facilities operations in 2000, which raised issues concerning DEMS-FM, significant work has been done to populate DEMS-FM with accurate information. DEMS-FM contains Defence's Estate Register, which details asset and equipment data on the Defence estate. ID now views DEMS as 'the single, authoritative source of Defence Estate asset and maintenance data.'<sup>51</sup> The wider-view of DEMS-FM, in CSIG, is that it is only a maintenance system. It contains financial data on the owned estate and leased properties where maintenance work has been undertaken since the system was implemented.

**5.13** DEMS-FM is accessible on the Defence Restricted Network to all staff with appropriate authorisation. Control mechanisms have been developed so that the accuracy of the Estate Register data is maintained. Contractors undertaking work on the estate can also access the system through external internet accounts that have been set up by Defence to enable them to update specific information. The system is accessed and populated daily by ID's regional office staff.

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<sup>51</sup> Corporate Services Infrastructure Group—Applicability of the Defence Estate Management System Draft, file reference 2000/19470 Part 5.

### *Property Index database*

5.14 Prior to estate data being entered into ROMAN, it is entered manually in the Property Index database to ensure data currency and accuracy. Maintained by CSIG Asset Policy and Accounting Section, the Property Index database is a Microsoft Excel spreadsheet that provides a numerical listing of all Defence properties with basis descriptive information relevant to each property.

5.15 ID staff have identified a large number of discrepancies between data in the three asset registers—ROMAN, DEMS-FM and the Property Index.

### *PMKeyS*

5.16 PMKeyS is Defence's personnel management and payroll system. It contains information relating to the physical location and the Output group that individual staff members belong to. Salary costs are allocated to cost centre codes that match the Group hierarchy in ROMAN. Information in PMKeyS details the location of staff, and therefore can validate occupancy data. PMKeyS' functionality is still being developed.

### *Premisys/MANTIS*

5.17 Premisys/MANTIS<sup>52</sup> is the property management system used by Defence's national property services contracted management firm (see next chapter). This system belongs to the firm but Defence owns the information that relates to the Defence property portfolio. It includes a detailed property register for all Defence leases managed by the management firm and contains financial information on those leases.

5.18 Defence has access to Premisys/MANTIS through stand-alone internet personal computers but many staff in the regional offices cannot access it, due to Defence's internet 'firewall'. During fieldwork, the ANAO was advised that, due to this lack of access, some regional staff assumed that Canberra (DPS) staff monitored the information on their behalf as well as from a national perspective. Defence later advised that the management firm recently developed a new system that avoids the firewall and addresses the access issue for regional staff. The new system is planned to be launched by the end of May 2002.

### *GFIS*

5.19 GFIS is a spatial management tool used by some ID staff, particularly those involved in base master planning and siting approval. GFIS is based on Microstation and Auto CAD formats. Few staff can access this information due

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<sup>52</sup> Premisys is the management information system. MANTIS is the tool which extracts the data from Premisys and presents it in a user-friendly form.

to software constraints. The CI Branch manages the data in GFIS, although external consultants and Regional Planning staff can also input data. Master planning documentation is stored on this system.

### *Pinnacle*

**5.20** Information Services Division's asset management system, Pinnacle, tracks IT equipment across Defence. It uses a hierarchy structure to identify asset location. Property numbers used in Pinnacle are being matched with those in DEMS for consistency of data. Pinnacle is one of the source systems used in the Activity Based Costing system being developed in CSIG.

### *Other databases*

**5.21** In addition to these titled systems, many spreadsheets/databases are in use throughout ID and the RICs. These include databases for Australian Valuation Office revaluation data, unexploded ordnance properties, Native Title claims, property disposal lists and Green Book<sup>53</sup> programming. Infrastructure, Planning and Environment Branch is in the process of developing a briefing paper and outlining the way forward on information management tools to be used in CSIG.

**5.22** CSIG accepts that there is a duplication of effort in data collection, resulting in numerous separate systems and spreadsheets, and that it needs one authoritative data source on Defence property. A working group in CSIG has been proposed to develop a strategy for the future development of an Estate Management System.

## **Conclusion**

**5.23** Poor access to the main information systems that hold data on Defence properties, and inconsistencies in that data, have led to unnecessary duplication of effort in establishing numerous subsidiary information systems of limited value. There is a continuing need for reliable data on Defence property location, value, occupancy and utilisation. The data is required not only for daily property management, but also for Customer Service Agreements and to meet the requirements of *The Commonwealth Property Principles*.

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<sup>53</sup> The Green Book is the title of the approved capital facilities program.

## Recommendation No.3

5.24 The ANAO recommends that Defence endeavour to establish an authoritative, reliable and accessible system for recording both accounting and management data on the location, value, occupancy and utilisation of each property in the Defence estate.

### *Defence response*

5.25 Agreed.

# 6. National Property Services Contract

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*This chapter examines Defence management of its national property services contract.*

## Background

**6.1** The only formal or structured aspect of Defence property management observed during the audit concerned management of Defence's numerous property leases, which was outsourced to a private-sector property management firm in 1998.<sup>54</sup> The contract, known as the national property services contract, is for management of Defence's 'expenditure leases' (Defence as lessee) and its 'revenue leases' (Defence as lessor) and the provision of specific property owner services.<sup>55</sup> The firm receives a fixed monthly management fee for these services.<sup>56</sup>

**6.2** The contract began in April 1998, after the management firm's purchase in 1997 of Australian Property Group (APG), the former Commonwealth property management agency which previously managed these services. Before the sale of APG, Defence had been preparing to call for tenders for the provision of property services. However, the preparations lapsed pending the sale outcome. Before the agreement with APG expired, Defence arranged that the new owner would continue the property services, initially for 12 months, to allow Defence to assess its performance.<sup>57</sup>

**6.3** The management firm's submission to Defence in 1998 indicated that it would provide a platform for significant ongoing improvements in service delivery, focusing on the following key areas:

- systems development—to provide Defence with a leading edge property information system;
- performance management—to develop with Defence a benchmark framework to enhance the performance of the property portfolio at strategic, operational and service levels, through the firm's access to global best practice and trends in property portfolio management and its significant benchmarking database;

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<sup>54</sup> *Contract Relating to Management Services for Property Portfolio*, April 1998.

<sup>55</sup> The ANAO examined Defence's management of the contract, not the contractor's operations.

<sup>56</sup> Additional consultancy fees are agreed per project, particular to the task to be undertaken.

<sup>57</sup> Defence Minute, 'Proposed Extension to Property Service Agreement,' December 1997, p. 1.

- enhanced service delivery—the service delivery model is to be jointly developed to ensure the right balance of information management, cost control and service delivery; and
- establishment of a high level Strategic Contract Committee to provide a vehicle for introduction of these substantive value-adding elements.

The submission became part of the contract.

**6.4** The national property services contract was not tested in the market. The original term of the contract was two years, with options for two one-year extensions. Defence exercised both options, and has further extended the term, to allow time to call for tenders for a new contract. Defence advised that the timing of a new contract for national property services has not yet been decided.

**6.5** Defence records indicate that the management firm managed some \$30 million of lease property expenditure for Defence in 2001; managed the collection of some \$5 million from Defence’s revenue leases in that year; and received \$1.68 million from Defence in managing agent fees for leases in 2001–02.<sup>58</sup>

**6.6** To carry out the work required under the contract, the firm has a supervising National Client Manager; two National Coordinators to oversee expenditure leases and revenue leases; and Client Managers and staff located in capital cities to support Defence’s Regional Infrastructure Centres (RICs).

## Defence arrangements for managing the leased estate

**6.7** The ID’s Directorate of Property Services (DPS) manages Defence’s acquisition and leasing of property and coordinates property management activities. DPS also manages the property management contract and Defence’s payments to the firm under the contract.

**6.8** DPS coordinates much of the property management centrally, supported by 12 RICs responsible for local management of the Defence estate. RIC managers report to the Director Estate Operations in the Estate Management Branch but RIC Property Officers seek technical guidance and instruction from DPS. RICs are responsible for local Defence estate day-to-day management. This includes repairs and maintenance, minor new works, property and environment management, and ensuring a link between the end user/tenants to the Infrastructure Division.<sup>59</sup>

<sup>58</sup> The figure for ‘managing agent fees for leases’ is published on the Defence website <[http://www.defence.gov.au/dmo/id/cic\\_contracts/cic\\_contracts.cfm](http://www.defence.gov.au/dmo/id/cic_contracts/cic_contracts.cfm)> under the heading ‘Contracts Gazetted from 1 July 2001 Valued at \$100 000 and above’.

<sup>59</sup> *Doing Business with Defence for Construction and Estate Management*, January 2002, <[www.defence.gov.au/id](http://www.defence.gov.au/id)>

**6.9** RICs liaise with the management firm's capital city offices on issues that arise in the region in relation to the leased estate. Issues include the expiration of leases or the need for new rental properties in the region. The firm does virtually all of this work, which, if not covered by the fixed fee (such as seeking additional rental property), may attract charges on a consultancy basis. The request for extra services may come from either DPS or from RICs, though extra services are usually coordinated and paid by DPS.

## Contract management issues

**6.10** Defence has been largely satisfied with the firm's management of its lease portfolio and the evidence is that the firm administers the leases in the way expected of a property agent. There was minimal evidence, however, of the innovations provided for in the contract (paragraph 6.3 above). The contract also states that:

... the [Strategic Contract] Committee will meet six monthly to assess:

- Performance—review current performance against service benchmarks for all services under the contract;
- Issues resolution—consider and advise on substantive issues raised by Defence or [the firm]; and
- Strategic initiatives—consider strategic initiatives from the National Client Manager or by the [firm's] General Manager emanating from [the firm's] corporate and government links in Australia and overseas.

**6.11** The ANAO considers that it would have been useful had Defence sought to introduce the innovations and had the Strategic Contract Committee been formed. There was no evidence that Defence gained access to global best practice and trends in property portfolio management and the significant benchmarking database as offered in the contract.<sup>60</sup> The firm's information management system 'Premisys' (see paragraph 5.17) was to include a system for monthly reporting of the firm's compliance with defined benchmarks. In practice, however, technical issues associated with the firm's system in Defence have limited the on-line access and the ability to monitor progress and performance.<sup>61</sup>

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<sup>60</sup> The firm advised that 'the provision of benchmarking services has been delayed as it does not have access to all Defence property costs—some of these are currently paid by Defence, making it difficult for the firm to provide a benchmarking service. ...'

<sup>61</sup> The firm advised that technical problems in the Defence IT environment have prevented access to Premisys and that a new reporting system has been developed that will enable access by all regions to Premisys.

## Key Performance Indicators (KPIs)

**6.12** The contract also provided that Defence and the firm would develop Key Performance Indicators (KPIs). Specifically it stated:

Achieving Key Performance Indicators (KPIs)—to be completed following the joint development by Defence and [the firm] of KPIs for each service. This column will detail how [the firm] will ensure the KPIs are achieved.

**6.13** When the ANAO asked about the KPIs late in 2001, they were not available. The ANAO understands that they were agreed shortly afterwards, in November 2001, more than three years after the contract began. They are set out at Appendix 1 to this report. Defence advised the ANAO in April 2002 that the KPIs are similar to those for other Commonwealth contracts and that most KPIs for the contract are pass / fail and therefore measurable.

**6.14** The ANAO supports the introduction of KPIs by public sector agencies as a way of quantifying outputs and assisting in objective performance assessment. It also supports their inclusion in service contracts to support formal contract performance assessment. With respect to KPIs in the contract, however, the ANAO notes that information is yet to be provided against the KPIs and that many are in the nature of broad assertions that would require further work to verify them. For example, the KPI ‘the Service Provider reports that are of a technical content to give stakeholders confidence of their decisions’ is unclear about the stakeholders and who is to assess performance. Also, inclusion of technical data does not, in itself, provide confidence about a decision, particularly if stakeholders do not understand the technical information.

**6.15** Similarly the KPIs ‘satisfactory Audit Reports’ and ‘no fraudulent activity, or misappropriation or duplication of payments of funds’ are not readily measurable using the information provided to Defence at the time of audit fieldwork.<sup>62</sup> The ANAO understands that Defence does not access the firm’s audit reports or make its own checks of financial arrangements.

**6.16** It is evident that KPIs have not been used to assess performance since insertion in the contract last year. The ANAO was advised that the KPIs are to be used to assess performance at the end of the first quarter of 2002. As a practical matter, however, it is difficult to see how they could be so used as the requirement for management data to support the KPIs is not included in the agreed monthly report proforma. Moreover, the contract is silent on linking the KPIs and the firm’s performance with the fixed monthly fee. The contract allows for fee adjustments relating to variations in the size of the property portfolio but it is

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<sup>62</sup> Defence’s standard Comprehensive Maintenance Contract (as at 17 April 2002) provides, at clause 16.4, that the contractor’s monthly report is to include a summary of its performance against agreed evaluation criteria, which are in effect KPIs.

silent on fee adjustments related to performance. In the absence of formal performance arrangements in previous years, and poor document management (see paragraph 6.23), it is also unclear that there was adequate evidence to support the extensions of the contract.

**6.17** The ANAO appreciates that the contract was not awarded competitively in 1998 and that DEO staff involved did not have the benefit of experience with contracts of that kind. The ANAO suggests that CSIG, when renewing the contract this year, seek expert advice in adopting a more commercial approach when formulating a new contract to give best value to the Commonwealth.

**6.18** The ANAO understands that existing, more commercially-based property management contracts provide for KPIs that require the identification and delivery of savings by reduction in the client's property costs. In response to ANAO's suggestion that Defence adopt a similar provision, Defence commented as follows:

Savings in property costs would need to be considered in the context of the total estate, both owned and leased. Presently there is no linkage between the two parts that would enable a whole-of-estate view on savings. A further issue for Defence is that in addition to the financial drivers, it must consider operational /strategic drivers.<sup>63</sup>

## **Delivery of service**

**6.19** Defence records indicate that a copy of the contract was provided to all regional offices in 1998. Some Regional Infrastructure Centres (RICs) visited by the ANAO, however, no longer had a copy of the contract, and most were unsure of the services to be provided under it. One RIC informed the audit team that it had recently requested a copy of the contract from DPS, to give them a better understanding of the firm's services included in the fixed monthly fee and services that attracted additional fees. In the event, the RIC received (from the firm) a copy of the contract annexure detailing information in the contract, but not a copy of the complete contract. The RIC was of the understanding that what they were provided by the firm was the complete contract.

**6.20** As indicated in Chapter 3, CSIG accepts that its regional offices need training and more central office guidance to sustain services, and ID accepts that it should provide policy and procedural guidance on numerous matters relevant to property management. The ANAO found that there has been little recent guidance provided to the RICs on property management. Guidance was issued by DPS in April 1999 but only one of seven<sup>64</sup> RIC offices visited was readily aware of it. Summary guidance for the contract is available on the Defence Estate Management Guide (accessible from both the Defence intranet and the external

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<sup>63</sup> Defence letter to ANAO, 10 April 2002, in response to ANAO Discussion Papers.

<sup>64</sup> Five RICs and two sub-RICs were visited during fieldwork.

Internet) but regional staff did not seem aware of this. Most regional staff are unsure of the delineation of responsibilities between themselves and the firm.

**6.21** Presentations at a Defence property conference<sup>65</sup> in September 2001 gave an overview of the roles and responsibilities of Defence estate staff and the firm, but no further written guidance resulted from the conference. Since then, there has been a great deal of staff movement in Defence, and many RIC Property Officers visited by the audit team are no longer in these roles and have been replaced by new staff.

**6.22** To help overcome problems of the kind identified above, DPS should provide written guidance to staff on their roles and responsibilities in relation to management of the property portfolio. These problems may be addressed as part of the consultancy project identified in paragraph 3.17. Clear guidance would allow a consistent approach to managing both the owned and leased estate in the regions and assist in the induction of new RIC staff.

## Document management

**6.23** Documentation regarding the national management of the contract by DPS could be improved. There was no specific file that contained current correspondence between Defence and the firm or documentation on contract matters such as extensions to the term of the contract. When requested, however, Defence staff were able to locate the contract extension documents the audit team sought.

**6.24** Better practice principles stress that it is important to keep relevant documentation relating to a contract together, to allow for visibility of decision making.<sup>66</sup> The only contract management issue evident on file concerned the firm's performance late in 1998. At the time of audit fieldwork, no up-to-date file list was available.

## Expenditure lease portfolio

**6.25** The major part of the firm's work under the contract is to manage Defence's expenditure leases (Defence as lessee). As at 1 March 2002, Defence had 371 expenditure leases. Defence leases property for a variety of reasons, including a lack of space on military bases, a requirement to have office space or to meet temporary accommodation requirements. The type of rental properties is diverse, and includes warehouses, car parks and office accommodation. In the first six months of 2001–02 financial year, expenditure on rent and associated property expenses amounted to \$19.5 million.

<sup>65</sup> Overheads from Property Conference, 26–27 September 2001. The Property Conference was attended by central and regional staff of the Defence Estate Management Branch.

<sup>66</sup> ANAO *Contract Management*, Better Practice Guide, February 2001, Canberra, p. 55.

**6.26** Critical dates, including the expiration of leases and rent reviews, are monitored and managed by Defence and the firm. Management is hampered by the lack of clarity in some regions about whether Defence or the firm is responsible for particular functions.

**6.27** Either DPS or the relevant RIC may initiate with the firm any extra services associated with the leased portfolio, such as a new lease to address a new capability requirement. Regardless of who makes the initial request, extra services are usually coordinated and paid by DPS. As a result of DPS involvement in these issues, regional Property Officers and the regional manager at times lack full visibility of the outcome. Payment of all the firm's invoices centrally at times contributes to this lack of regional visibility. Better communication between DPS and the RICs regarding the firm's services would allow for better monitoring of its work.

## Payments to the management firm

### The contract and FMA Act

**6.28** Under Defence's property management contract, Defence pays the firm amounts in advance each month for rent due on the first day of the following month to the owners of property that Defence occupies. As the contract makes the firm an agent of Defence, the ANAO suggested to Defence that advance payments of rent to the firm are public money under the *Financial Management and Accountability Act 1997* (FMA Act) in the firm's accounts and that Defence should account for the money until the firm pays the property owners. Defence indicated in response that its practice is to treat payments to the firm as payments to a third party and therefore beyond the scope of the FMA Act.

**6.29** The Australian Government Solicitor's Office (AGSO) subsequently advised the ANAO that money paid by Defence to the firm for rent payments, and held by the firm for payment to third parties, is public money for the purposes of the FMA Act. AGSO also advised that the firm's employees performing financial tasks for Defence in respect of that money are to be regarded as officials under the FMA Act and that Defence should account for the money in official accounts until the firm pays it to third parties. A corresponding situation arises under the FMA Act in respect of rent collected by the firm from Defence's tenants. The ANAO provided a copy of the advising to Defence.

**6.30** At the time of preparing this report, Defence was considering the implications of the advising in consultation with the firm and how best to ensure that the financial arrangements comply with the FMA Act. The ANAO also asked Defence to consider how to account for any interest that the firm received on

money in the firm's accounts before the money was paid to property owners, and any interest that the firm received on rent from Defence's tenants while in the firm's accounts.

**6.31** The audit findings and comments below are based on Defence operations at the time of audit; that is, before making any changes to the financial arrangements with the firm to comply with the FMA Act in the way indicated by the AGSO advice.

## **Payment under the property services contract**

**6.32** Under the contract, Defence pays the firm, monthly, a management service fee; reimbursements of property expenses; and advance payments to meet lease rent due to property owners on the first day of the following month. The monthly payments are made by electronic funds transfer (EFT).

**6.33** Payment is made after receiving a monthly statement from the firm, submitted under the following contract provision:

[The firm] must provide to the Department by the 24<sup>th</sup> of each month, a consolidated statement of all payments made for Lease and Service Contracts for that month. The consolidated invoice must include:

1. A list by property of all payments made and to be made by [the firm] for which reimbursement is sought; and
2. Verification in relation to each invoice that the amount is correct and reasonable and has been paid in accordance with Lease and Service Contracts.

The Department must reimburse [the firm] within five business days after it receives the claim with the above information.<sup>67</sup>

**6.34** The provision is confusing because it appears to require verification and reimbursement of payments 'to be made' as though they have been made. Further confusion arises because the firm's consolidated invoices are titled 'Reimbursement for the month of X'. The signed Defence Estate Payment Advice declaration verifies/certifies<sup>68</sup> that the goods/services detailed in the invoice have been received/completed. The ANAO notes, however, that claims in these consolidated invoices for rent payments (about 95 per cent of the total monthly invoice amounts) are actually for prepayments to the firm for services not yet provided.

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<sup>67</sup> Contract—Annexure to Schedule 1.

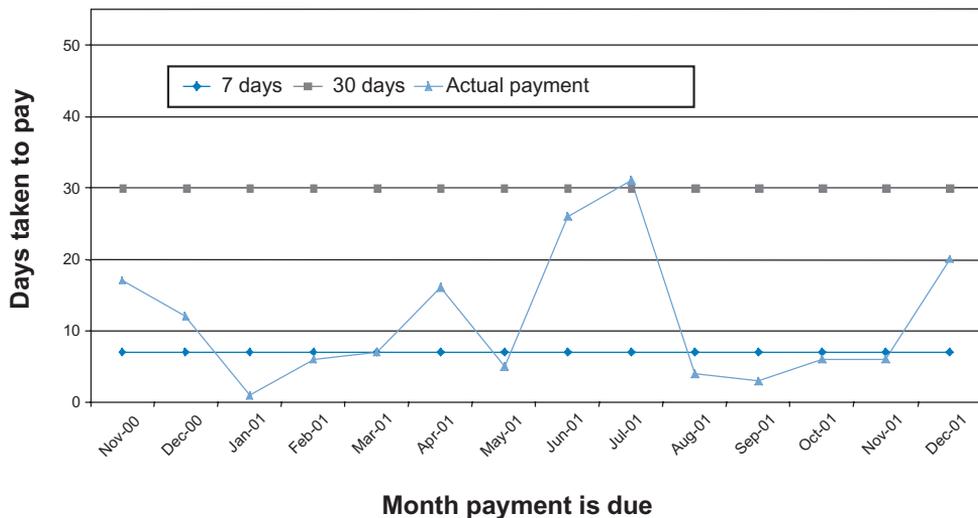
<sup>68</sup> The Defence Estate Payment Advice declaration (attached to the invoice requiring payment) changed from 'As a Purchasing Approver, I certify that ...' to 'As a Purchasing Officer, I verify that ...' in June–July 2001.

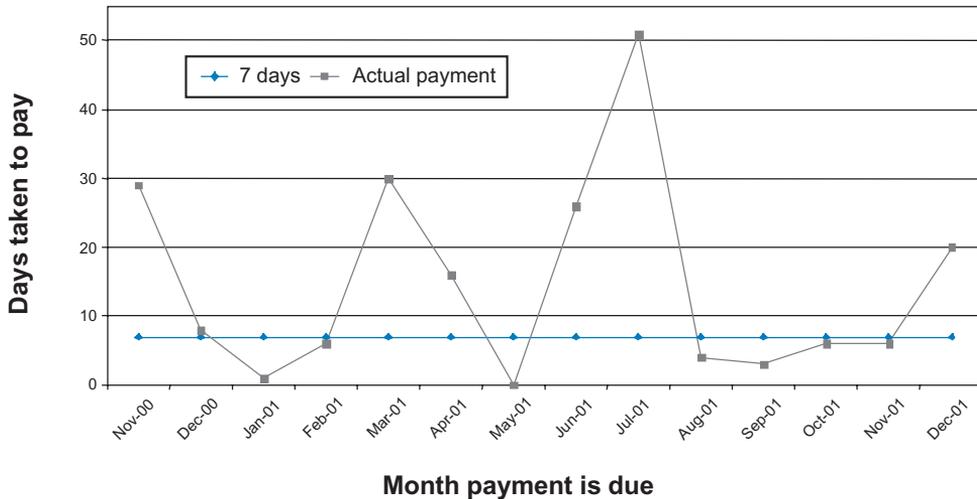
6.35 The contract provision quoted above indicates that the firm must provide consolidated invoices by the 24<sup>th</sup> of each month, for 'reimbursement' within five business days. Another provision (clause 7) of the contract states that invoices for fees and reimbursements are to be submitted, monthly in arrears and that Defence must pay the fixed monthly service fee within seven days, and all other amounts due under the contract within 30 days of receiving the invoice. The firm's monthly invoices sighted by the ANAO stated that payment was due on the 24<sup>th</sup> of the month. The invoices did not show the date they were received in Defence. Defence usually paid by the due date specified on the statement, with an annotation by Defence staff that payments were to be made 'as per contract.'

6.36 Figures 3 and 4 illustrate inconsistencies in payment times to the firm. It is not apparent to the ANAO how all these payments could have been made 'as per contract', as they are not in accordance with either the seven day or 30 day timeframe.

**Figure 3**

**Number of days taken to pay consolidated invoice**



**Figure 4****Number of days taken to pay management fee**

Source of Figures 3 and 4: ANAO analysis of Defence data.

**6.37** Consolidated invoices are supported by monthly reports from the firm. Over the life of the contract, the format of the reports has evolved and the level of information in them have varied in response to Defence's management information needs. The monthly statement now includes two consolidated invoices that total the invoices the firm has received on Defence's behalf for that month. One consolidated invoice is for East Timor related invoices; the other is for the remainder of Defence lease expenditure. An invoice for the firm's monthly fee is also included.

**6.38** Formal approval of the firm's invoices is subject to requirements in the Financial Management and Accountability Regulations (FMAR) and Defence's Chief Executive Instructions (CEI).<sup>69</sup>

The FMAR state:

*Approval of spending proposals – principles*

9. 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 proposed expenditure:

- (a) is in accordance with the policies of the Commonwealth; and
- (b) will make efficient and effective use of public money. ...

<sup>69</sup> FMAR and CEI are made under the *Financial Management and Accountability Act 1997*.

The CEI state:

*Payment of Accounts*

1.2. Under the legislative framework of the *Financial Management and Accountability Act 1997*, there is a change in the control focus from the payment process to the purchase process. The key principle is to move the control emphasis to the purchasing function and to have the payment function become more of an administrative process. The overall responsibility for management of the payment of accounts function will reside with the line managers through an organisational structure, not a financial delegations structure. ...

1.4. Supervisors are to ensure that authorised officials have the skills and abilities to perform their duties. ...

1.21. A key principle in the payment of accounts in Defence is that the goods or services must be satisfactorily received or performed. The decision to accept goods or services must be documented and the date of the decision recorded.

1.22. Documentation that forms an integral part of any payment process is to be retained ...

**6.39** Against a background of uncertainty regarding due dates for payment under the contract, a lack of KPIs for the first three years of the contract and, as indicated in paragraph 6.34, invoices verified / certified for 'reimbursement' that were mainly for payments in advance, Defence it is unclear whether, in pursuance of FMAR 9 above, the approver was in a position to be satisfied about the payments. Normally, a junior staff member confirmed the monthly claims as correct, leaving it uncertain whether, in pursuance of CEI 1.2 above, the 'line manager' took overall responsibility for the payment function.

**6.40** Since each monthly payment is at least \$2.5 million (totalling some \$30 million a year), this area needs to be reviewed to ensure compliance with formal requirements regarding payment of public money. The ANAO understands that the CEI are being reviewed. The ANAO would suggest that Defence consider the Department of Finance and Administration's CEI regarding contract related payments, which puts responsibility on to the contract manager.<sup>70</sup> It would also be desirable to clarify the payments provisions of the contract and to ensure that payments provisions in the new contract avoid ambiguity of the kind apparent at present.

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<sup>70</sup> The Department of Finance and Administration CEI on *Payment of Accounts* (issue 1/01) provides as follows:

- 4.1(2) Where the payment relates to a contract or an agreement, the Business Group officials must also ensure that:
- (a) any periodic or progress payment has been verified by the Contract Manager as due and payable within the terms of the contract; and
  - (b) the claim has been cleared for payment by the Contract Manager for the contract.

**6.41** The issue of staff awareness of, and compliance with, the CEIs was raised in the earlier ANAO audit reports on Defence Estate and in the JCPAA review of the latter report. The JCPAA commented:

DEO assured the Committee that it was endeavouring to correct the situation. Annual workshops on *Chief Executive Instructions* were to be conducted for senior staff, who were expected to pass on this training to more junior staff. 'We have made a concentrated effort, particularly since the ANAO has highlighted some of the deficiencies in the awareness of our staff, and we intend to continue that.'

The Committee believes that a filter-down effect is insufficient to achieve cultural change, given that in 2001 ANAO found that Defence's implementation of audit recommendations from its 1999–2000 report on Defence estate project delivery 'has had little effect' and during this audit, REC [Regional Estate Centre] staff 'were not aware that an updated version of the *Chief Executive Instructions* had been issued.' In order to effect cultural change, Defence has to ensure that all line officers develop the practice of consulting the *Chief Executive Instructions* before entering into any contract or agreement to purchase goods and services.<sup>71</sup>

## Interest forgone

**6.42** As discussed above, the monthly payments to the management firm mainly comprise advance payments to meet rent due to property owners. Due to ambiguities in the contract, it is not clear from the contract when the payments are to be paid to the firm. Under the leases, the firm is due to pay property owners on Defence's behalf by the 1<sup>st</sup> of the month. On average, Defence makes the payments to the firm six days prior to the 1<sup>st</sup> of the month.

**6.43** In the ANAO's view, the payments are unnecessarily early. From the Commonwealth's cash management viewpoint, it results in interest forgone by the Commonwealth. The ANAO estimates that the interest forgone by the Commonwealth from these early rent payments amounted to \$26 000 over the two-year period analysed (from January 2000 to December 2001).<sup>72</sup>

**6.44** To avoid interest forgone by the Commonwealth, Defence could arrange to make rent payments, not through the firm, but direct to property owners on the 1<sup>st</sup> of the month by means such as EFT. The ANAO noted the Commonwealth's commitment to paying all suppliers electronically<sup>73</sup> and that the suppliers in this case are the property owners.

<sup>71</sup> Joint Committee of Public Accounts and Audit, *Report 385*, August 2001, Canberra, paragraphs, pp. 46 and 47.

<sup>72</sup> The percentages used to calculate the interest forgone were extracted from the Reserve Bank of Australia, one month Treasury note yields data field. The percentages varied from 4.2 to 6.3 per cent p.a. over the two-year period from January 2000 to December 2001.

<sup>73</sup> The *Commonwealth Procurement Guidelines and Best Practice Guidance* issued by the Minister for Finance and Administration (October 2001) state (section 1.4) that 'The Commonwealth is committed to paying all suppliers to Government electronically'.

**6.45** Defence considered, however, that it would be impracticable for it to pay property owners direct, because there are some 371 property owners involved and, in practice, there can be delays in EFT. Defence notes that payment of Defence's rent is a key component of the national property services contract. Defence preferred to make bulk payments in advance to the firm, which, as Defence's agent, can pay individual property owners, using EFT as appropriate. The ANAO accepted this, noting that Defence should seek to avoid unnecessarily early payments to the firm for rent due on Defence leases.

## **Management fees**

**6.46** As mentioned earlier, the firm is paid a fixed monthly fee for management of Defence's leased property portfolio. Extra fees are paid for specific projects not included in the original service requirement. Defence does not capture data on these additional fees well, even though all fee payments are made centrally by DPS.

**6.47** Defence should collate data on all fees paid to the firm and assess them against the work done, as part of the process of assessing performance against industry benchmarks. The data would also assist in assessing tenders for the forthcoming contract renewal process.

## **Revenue lease portfolio**

**6.48** Defence, as an incident to its large property holdings, has numerous 'revenue leases' (Defence as lessor). It lets a variety of properties including warehouses, docks, paddocks and workshops. Rentals include long leases, licence agreements and short-term hire agreements.

**6.49** Some Defence properties serve as buffer zones (often for urban encroachment and noise pollution) near military bases, and the land may be available for grazing licences on terms and conditions that suit Defence purposes. This provides Defence with some security regarding the use of the land. Defence also grants leases to contractors where there is an identified need for the contractor to be on Defence property. Defence tenants are varied and include contractors providing services on Defence premises.

**6.50** The contract requires the firm to negotiate leases and licence agreements in consultation with Defence, and to have regard to Defence policy, operational and legal issues.<sup>74</sup> The firm also deals with tenant enquiries and issues relating to the use of Defence properties.<sup>75</sup> On Defence's behalf, the firm invoiced \$5.1 million<sup>76</sup> in rent in 2000–01.

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<sup>74</sup> Contract—Annexure to Schedule 1.

<sup>75</sup> *ibid.*

<sup>76</sup> This figure is from the firm's Mantis internet site and it represents the amount that the firm invoiced on behalf of Defence for the 2000–01 financial year.

## Contract management of revenue leases

**6.51** Evidence available to the ANAO during fieldwork indicated that there was minimal Defence contract management on some of the firm's services relating to the revenue lease portfolio. The firm's monthly report concerned imminent critical dates<sup>77</sup> and ongoing project reports on new lease arrangements and property management issues. At the time of audit fieldwork, financial debtor reports were not included in the monthly reports and were not readily available in Defence. At that time, Defence was not aware of the overall financial status of the revenue lease portfolio. Since February 2002, debtor reports form part of the monthly report. Defence advised that, with the benefit of these monthly reports, issues arising in the revenue lease portfolio are addressed regularly by Defence.

**6.52** The ANAO noted some inadequacies regarding revenue leases. Defence's standard Comprehensive Maintenance Contracts (CMCs) provide that contractor may be granted a conditional licence to occupy Defence premises to perform the work and to pay rent.<sup>78</sup> There are many CMC contractors located throughout Defence establishments but the firm's MANTIS<sup>79</sup> October 2001 list of revenue leases (maintained on Defence's behalf) included only two lease/licence agreements for Defence premises. The firm informed the ANAO that, once firms are successful in gaining a contract, they are often unwilling to accept the standard licence conditions and to complete the licence agreements. Subsequently, however, the ANAO noted that the early March 2002 version of the database showed 36 lease/licence agreements in place for premises with CMC contractors. Garrison support contractors are noticeably absent from the database.<sup>80</sup>

**6.53** Defence and the firm have tried to ensure that non-Defence personnel using Defence facilities are identified and subject to standard licences or leases. Defence advised that the firm is conducting a 'muster' of the users of Defence facilities, as there are still numerous non-Defence users not yet subject to a lease or licence.

**6.54** A recent Defence internal audit report on commercial use of Defence facilities commented that there were a number of instances where there was no lease or licences in place with commercial entities. Where there were agreements, rental reviews were not always conducted as and when stipulated. Nor was there adequate confirmation that lessees or licensees had the required public

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<sup>77</sup> Dates relating to imminent rent reviews and lease renewals and expiries.

<sup>78</sup> If a facility is 'mandated' for use by a contractor, Defence often seeks a peppercorn rental. Where the facility is deemed 'optional', a commercial rent is to be charged depending on the extent of commercial use by the contractor.

<sup>79</sup> See paragraph 5.17.

<sup>80</sup> CMCs do not cover cleaning and grounds maintenance, which are already covered by Service Delivery Division's Garrison Services contracts.

liability and indemnity insurance to protect the Commonwealth's interest. The audit report also commented that, establishing lease or licence agreements with non-Defence users on Defence facilities:

provides a legal basis for setting out the responsibilities and obligations for both parties to an agreement that enables entities to commercially use Defence property. Without complete and up to date documentation there can be no assurance that the Commonwealth's interest are being adequately protected.<sup>81</sup>

**6.55** A new Defence Instruction covering this area was released for wider distribution in March 2002. Issues raised in the new instruction have been circulated in Defence since 1986. Although the requirement to have leases or licences with non-Defence users is not new, there are still users who do not have such agreements in place.

## **Financial management of revenue leases**

**6.56** The discussion below is subject to comments at paragraphs 6.29–6.31.

**6.57** The management firm invoices Defence's tenants each month and collects the revenue in the firm's bank accounts from which the revenue is forwarded to Defence monthly in three cheques (Victoria region; New South Wales region; and a combination of other regions). The firm draws the cheques in Canberra and forwards them to the firm's Financial Officer in Sydney with details of the revenue payments included in each cheque. At the time of audit fieldwork, the cheques were sent on to DPS in Canberra, where they were forwarded to the financial section and presented for payment.<sup>82</sup>

**6.58** This lengthy process is not in the best interest of the Commonwealth. In addition to the time the money remains in the firm's account prior to the cheque being created (up to 30 days from when the tenant pays the invoice), a further 24 days elapse (on average) before the cheques are received and presented by Defence. Based on the number of days that elapsed from the time that the firm drew the cheque until it was presented by Defence, the ANAO estimates that interest forgone by the Commonwealth over the last two years at \$35 000.<sup>83</sup> (The ANAO is unaware of the period that elapsed each month from the time that Defence tenants paid rent to the firm until the firm drew the cheque for Defence.)

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<sup>81</sup> Inspector-General's Division, *Management Audit Branch Review of Commercial Use of Defence Facilities—Western Region*, WA01/37, August 2001.

<sup>82</sup> The firm advised in May 2002 that the current procedure ensures that Defence receives associated paper work with the cheques showing a breakdown of income and GST by State.

<sup>83</sup> The percentages used to calculate the interest forgone were extracted from the Reserve Bank of Australia, one month Treasury note yields data field. The percentages varied from 4.2 to 6.3 per cent p.a. over the two-year period. The time period used for this calculation was readily available, although the location of the cheque in that period was unclear.

**6.59** To avoid late payment of revenue to Defence, the firm could arrange to transfer the revenue direct to Defence via electronic funds transfer (EFT). The firm indicated that this method is used for its other clients and, with Defence's agreement, a monthly payment could be made by EFT to Defence, and associated paperwork forwarded by mail for reconciliation with the EFT. This would ensure that Defence rent receipts are timely.

**6.60** As indicated in paragraph 6.50, the firm invoiced Defence tenants \$5.1 million in rent in 2000–01. In that year, however, Defence presented the firm's cheques totalling only \$4.3 million. Three additional cheques for \$425 000, drawn by the firm on 8 June 2001, were presented by Defence on 18 July 2001. (The monthly cheques do not necessarily match what has been invoiced the previous month). As at 27 July 2001, the firm's revenue debtors report indicated that \$975 000 in revenue lease invoices was outstanding to Defence, of which approximately \$440 000 was more than 30 days overdue, including \$300 000 more than 90 days overdue. (The firm advised the ANAO in May 2002 that less than a third of the \$300 000 was subject to routine recovery action, with the remainder subject to specific circumstances.) As at 4 December 2001, revenue lease debt overdue by more than 90 days had increased to \$335 000.

**6.61** The firm compiles a monthly debtors report<sup>84</sup> on revenue owing to Defence by lessees. The report is provided to the firm's appropriate client manager to follow up. The firm informed the ANAO that a copy of the report is forwarded to DPS who, in turn, can pass it to the financial area of Defence for reporting purposes. However, when the ANAO sought these reports in Defence, many could not be provided. As mentioned in paragraph 6.51, Defence advised that debtor reports have been included in the firm's monthly reports since February 2002.

**6.62** The firm is also to report quarterly to Defence on income received in respect of each property. Defence files contained some quarterly summaries, but lacked detailed information on income per property. The lack of information available in Defence indicate that there is only minimal income and debtor oversight of the revenue portfolio in ID.

**6.63** Defence has a statutory responsibility to pursue recovery of debt due to it. Identification of Defence's overall position regarding debts due has been raised as an issue in the ANAO's annual financial statement audit process.<sup>85</sup> It is not

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<sup>84</sup> The debtors reports provide a debt age analysis of amounts 30, 60 and 90 days late. There was no evidence that these reports are provided to the appropriate Defence areas that need to report on debt under s49 of the *Financial Management and Accountability Act 1997*.

<sup>85</sup> Section 47 of the FMA Act states that 'a Chief Executive must pursue recovery of each debt for which the Chief Executive is responsible'. A recent ANAO report commented, in respect of Defence's debt management, that 'the extent to which debt is recorded in the corporate systems, aged debtor report reports are prepared and used to manage debt, and appropriate Defence action to recover overdue debts is currently unclear.' (Audit Report No.29 2001–2002 *Audits of the Financial Statements of Commonwealth Entities for the Period Ended 20 June 2001*, p. 56).

clear whether data on debts due on revenue leases is collated by Defence's central finance area for inclusion in the annual financial statements.

## Conclusion

**6.64** Under the national property services contract, the management firm arranges payment for Defence of some \$30 million a year in rent and receives some \$5 million a year in rent from Defence's tenants. Legal advice indicates that present arrangements for the firm, as Defence's agent, to hold rent due by and to Defence need to be changed to accord with the *Financial Management and Accountability Act 1997*.

**6.65** Property management in Defence's regional offices could be improved by providing regional staff with clear guidance on the delineation of service responsibilities between Defence and the firm. Central office management could be improved by better scrutiny of contractor performance and invoices. Payments should be made in accordance with formal instructions and contract provisions.

**6.66** Defence should continue to formalise 'revenue lease' arrangements with contractors and other non-Defence personnel using Defence facilities. Revenue due on such leases should be monitored and recovery action on outstanding debt taken in accordance with Defence's responsibilities to pursue recovery of debts due to it.

**6.67** The present contract is due to expire soon, and Defence is preparing to call for tenders for a new contract. It could take the opportunity to review its experience with the present contract to ensure that the new contract best meets its needs in managing the leased estate. It would, for example, be useful to collate data on the cost of managing the present contract, and the management fees paid to the contractor, to assist in benchmarking with industry standards and in assessing tenders for the new contract.

**6.68** Given that the present contract was not let competitively and that Defence has limited experience in letting a contract of this kind, it would also be useful to engage suitable expertise to advise on terms, conditions and key performance indicators for the new contract. Defence has advised that the timing for a new contract covering national property services has not yet been decided, but the considerations involved are being actively developed.

## Recommendation No.4

6.69 The ANAO recommends that, to improve management of the property services contract, Defence:

- a) provide Infrastructure Division's regional property management staff with clear guidance on the delineation of responsibilities between Defence and the management firm;
- b) ensure that financial arrangements with the management firm, as Defence's agent under the contract, comply with the *Financial Management and Accountability Act 1997*;
- c) ensure appropriate processes are in place for 'line managers' to authorise claims for payment against the relevant contract; and
- d) ensure that revenue leases and licences are issued and recorded and that collection of revenue from them is monitored.

### *Defence response*

6.70 Agreed.

## Recommendation No.5

6.71 The ANAO recommends that, to assist in formulating a new property management contract that would give best value to the Commonwealth, Defence:

- a) collate data on the cost of managing the relevant contract, and the management fees paid, for benchmarking with industry standards and to assist in assessing tenders for the replacement contract; and
- b) engage suitable expertise to advise on terms, conditions and key performance indicators for the new contract.

*Defence response*

6.72 Defence provided the following response to Recommendation No.5:

- a) Agreed in Principle. Capture of costs will assist in benchmarking, however, the services provided under the extant contract will not necessarily be duplicated under a replacement contract. A contract improvement and review process will determine the Statement of Requirement, which may be different to the current scope of the contract and therefore the current costs may not provide a direct correlation to the bids for the new contract.
  - b) Agreed.
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Canberra ACT  
17 June 2002



P. J. Barrett  
Auditor-General

# Appendices



## Appendix 1

### KPIs in National Property Services Contract

Defence's 1998 National Property Services Contract with a private-sector property management firm provided for key performance indicators (KPIs) to be jointly developed. As a result, in late 2001, the Annexure to Schedule 1, 'Achieving Key Performance Indicators' column was completed. A summary of this information is below.

#### Expenditure lease portfolio

##### *Financial management*

- no breaches in lease or other agreement terms and conditions with all payment obligations being met;
- correct payments made;
- satisfactory Audit Reports;
- no fraudulent activity, or misappropriation or duplication of payments of funds; and
- reports provided are accurate and provide the required level of data to enable expenditure to be tracked and reconciled.

##### *Lease management*

- Property Management System enables Defence to track all aspects of POE and accommodation Services;
- approval obtained from Defence's Delegate prior to committing to any renewal of the lease;
- the Service Provider reports that are:
  - provided within timeframes that allow Defence reasonable time to make relevant decisions in respect to accepting the strategy to renew the lease;
  - timely in terms of meeting the provisions of the lease terms and conditions; and
  - of a technical content to give stakeholders confidence of their decisions.
- comply with Applicable Requirements and provide probity and accountability assured processes and outcomes;
- outcomes that are consistent with Defence's strategic and individual property plans;

- time limits designated in lease documentation are met;
- achieve rental rates that are below or are consistent with market levels;
- the Service Provider data base amended on completion of lease renewal process;
- approval obtained from Defence's Delegate prior to committing to any new rent;
- approval obtained from Defence's Delegate prior to issuing formal termination notice;
- Approval obtained from Defence prior to:
  - commencing the negotiation process;
  - committing to new lease (Defence delegate approval required); and
  - entry into a contract.
- any correspondence or other written material that is prepared in response to queries from ANAO, Parliament, Parliamentary Committees and/or Ministers is provided at an agreed timeframe set by Defence's Contract Manager; and
- fitouts are in accordance with agreed user brief and completed within time and budget.

## **Revenue lease portfolio**

In addition to the above, specific points identified for the revenue lease portfolio services are:

- table annual Programme of Property Inspections with Defence at an agreed timeframe;
- complete building inspections within the agreed timeframe;
- property inspection reports are provided within four weeks of each inspection;
- standard suite of documents developed;
- procedures in accordance with LAA requirements; and
- agreed milestones are met.

## Appendix 2

### Performance Audits in Defence

Set out below are the titles of the ANAO's previous performance audit reports on Defence operations tabled in the Parliament in the last five years.

Audit Report No.5 1997–98  
*Performance Management of Defence Inventory*

Audit Report No.34 1997–98  
*New Submarine Project*

Audit Report No.43 1997–98  
*Life-cycle Costing in Defence*

Audit Report No.2 1998–99  
*Commercial Support Program*

Audit Report No.17 1998–99  
*Acquisition of Aerospace Simulators*

Audit Report No.41 1998–99  
*General Service Vehicle Fleet*

Audit Report No.44 1998–99  
*Naval Aviation Force*

Audit Report No.46 1998–99  
*Redress of Grievances in the ADF*

Audit Report No.13 1999–2000  
*Management of Major Equipment Acquisition Projects*

Audit Report No.26 1999–2000  
*Army Individual Readiness Notice*

Audit Report No.35 1999–2000  
*Retention of Military Personnel*

Audit Report No.37 1999–2000  
*Defence Estate Project Delivery*

Audit Report No.40 1999–2000  
*Tactical Fighter Operations*

Audit Report No.41 1999–2000  
*Commonwealth Emergency Management Arrangements*

Audit Report No.45 1999–2000  
*Commonwealth Foreign Exchange Risk Management Practices*

Audit Report No.50 1999–2000  
*Management Audit Branch—follow-up*

Audit Report No.3 2000–2001  
*Environmental Management of Commonwealth Land—follow-up*

Audit Report No.8 2000–2001  
*Amphibious Transport Ship Project*

Audit Report No.11 2000–2001  
*Knowledge System Equipment Acquisition Projects in Defence*

Audit Report No.22 2000–2001  
*Fraud Control in Defence*

Audit Report No.26 2000–2001  
*Defence Estate Facilities Operations*

Audit Report No.32 2000–2001  
*Defence Cooperation Program*

Audit Report No.33 2000–2001  
*ADF Reserves*

Audit Report No.41 2000–2001  
*Causes and Consequences of Personnel Postings in the ADF*

Audit Report No.51 2000–2001  
*ADF Health Services—follow-up*

Audit Report No.16 2001–2002  
*Defence Reform Program—  
Management and Outcomes*

Audit Report No.24 2001–2002  
*Status Reporting of Major Defence  
Equipment Acquisition Projects*

Audit Report No.30 2001–2002  
*Test and Evaluation of Major Defence  
Equipment Acquisitions*

Audit Report No.38 2001–2002  
*Management of ADF Deployments to  
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Audit Report No.44 2001–2002  
*ADF Fuel Management*

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Audit Report No.56 Performance Audit  
*Workforce Planning in the Department of Immigration and Multicultural and Indigenous Affairs*

Audit Report No.55 Performance Audit  
*Administration of Tobacco Excise*  
Australian Taxation Office

Audit Report No.54 Performance Audit  
*Drug Detection in Air and Containerised Sea Cargo and Small Craft*  
Australian Customs Service

Audit Report No.53 Assurance and Control Assessment Audit  
*Goods and Services Tax Administration by Commonwealth Organisations*

Audit Report No.52 Financial Control and Administration Audit  
*Internal Budgeting*

Audit Report No.51 Performance Audit  
*Research Project Management*  
Commonwealth Scientific and Industrial Research Organisation (CSIRO)

Audit Report No.50  
*A Preliminary Examination into the Allocation of Grant Funding for the Co-Location of National General Practice Organisations*

Audit Report No.49 Performance Audit  
*The Management of Commonwealth National Parks and Reserves  
'Conserving our Country'*  
Department of the Environment and Heritage

Audit Report No.48 Performance Audit  
*Regional Assistance Programme*  
Department of Transport and Regional Services

Audit Report No.47 Performance Audit  
*Administration of the 30 Per Cent Private Health Insurance Rebate*  
Department of Health and Ageing, Health Insurance Commission, Australian Taxation Office, Department of Finance and Administration, Department of the Treasury

Audit Report No.46 Performance Audit  
*Management of an IT Outsourcing Contract*  
Department of Veterans' Affairs

Audit Report No.45 Assurance and Control Assessment Audit  
*Recordkeeping*

Audit Report No.44 Performance Audit  
*Australian Defence Force Fuel Management*  
Department of Defence

Audit Report No.43 Performance Audit  
*Indigenous Education Strategies*  
Department of Education, Science and Training

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*Management of the Provision of Information to Job Seekers*  
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Audit Report No.38 Performance Audit  
*Management of Australian Defence Force Deployments to East Timor*  
Department of Defence

Audit Report No.37 Performance Audit  
*Purchase of Hospital Services from State Governments—Follow Up Audit*  
Department of Veterans' Affairs

Audit Report No.36 Benchmarking Study  
*Benchmarking Implementation and Production Costs of Financial Management Information Systems*

Audit Report No.35 Performance Audit  
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Australian Taxation Office

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*Developing Policy Advice*  
Department of Education, Training and Youth Affairs, Department of Employment, Workplace Relations and Small Business, Department of Family and Community Services

Audit Report No.20 Performance Audit  
*Fraud Control Arrangements in the Department of Agriculture, Fisheries and Forestry—Australia (AFFA)*  
Department of Agriculture, Fisheries and Forestry—Australia

Audit Report No.19 Assurance and Control Assessment Audit  
*Payroll Management*

Audit Report No.18 Performance Audit  
*Performance Information in Portfolio Budget Statements*

Audit Report No.17 Performance Audit  
*Administration of Petroleum Excise Collections*  
Australian Taxation Office

Audit Report No.16 Performance Audit  
*Defence Reform Program Management and Outcomes*  
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*Agencies' Oversight of Works Australia Client Advances*

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*Selection, Implementation and Management of Financial Management Information Systems in Commonwealth Agencies*

Audit Report No.11 Performance Audit  
*Administration of the Federation Fund Programme*

Audit Report No.10 Assurance and Control Assessment Audit  
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Audit Report No.9 Performance Audit  
*Learning for Skills and Knowledge—Customer Service Officers*  
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Audit Report No.8 Assurance and Control Assessment Audit  
*Disposal of Infrastructure, Plant and Equipment*

Audit Report No.7 Audit Activity Report  
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*Commonwealth Fisheries Management: Follow-up Audit*  
Australian Fisheries Management Authority

Audit Report No.5 Performance Audit  
*Parliamentarians' Entitlements: 1999–2000*

Audit Report No.4 Performance Audit  
*Commonwealth Estate Property Sales*  
Department of Finance and Administration

Audit Report No.3 Performance Audit  
*The Australian Taxation Office's Administration of Taxation Rulings*  
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Audit Report No.2 Performance Audit  
*Examination of Allegations Relating to Sales Tax Fraud*  
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