

The Auditor-General

Audit Report No.24

Performance Audit

DAS Business Unit Sales Management

Australian National Audit Office

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Canberra ACT
18 December 1998

Dear Madam President
Dear Mr Speaker

The Australian National Audit Office has undertaken a performance audit of the management of the sale of the former Department of Administrative Services' commercial business units 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 *DAS Business Unit Sales 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

AUDITING FOR AUSTRALIA

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

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Abbreviations/Glossary

ANAO	Australian National Audit Office
APG	Former Australian Property Group
AOSS	Australian Operational Support Services
Barings	Baring Brothers Burrows & Co., Limited
DAS	Former Department of Administrative Services
DASCEM	DAS Centre for Environmental Management
DASFLEET	Former DAS Business Unit
DOF	Former Department of Finance
DOFA	Department of Finance and Administration
OASITO	Office of Asset Sales and IT Outsourcing
DAS Interiors	Former DAS Interiors Australia

Summary and Recommendations

Summary

Background

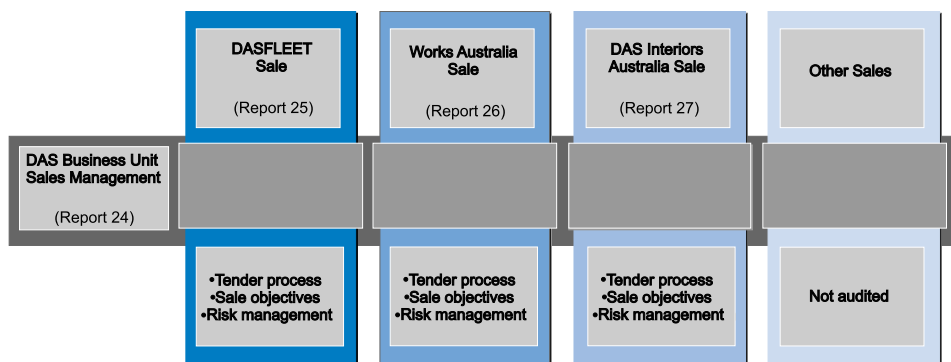
1. Between July and October 1997, sale contracts were signed for each of eight former Department of Administrative Services (DAS)¹ commercial business units. The sales raised gross proceeds of \$437 million.
2. Following reviews of each of the then thirteen DAS commercial business units, the Government announced in the August 1996 Budget the intended sale of the following six business units:
 - DASFLEET, which provided passenger and general commercial vehicle leasing, rental and fleet management and maintenance services;
 - Asset Services, which was responsible for maintenance and repairs, minor property improvement and professional technical advice on facilities and related equipment;
 - DAS Centre for Environmental Management (DASCEM), which was responsible for management of ozone depleting substances and environmental consulting services;
 - DAS Distribution, which provided domestic freight, international freight and warehousing and distribution services;
 - DAS Interiors Australia (DAS Interiors), which provided strategic advice and planning for accommodation, design/documentation and supervision of office fit-out and high-technology engineering services; and
 - Works Australia, which provided project management, architectural and engineering design and documentation services.
3. In addition, Australian Operational Support Services (AOSS), which provided facilities support services and was prime contractor for the Sydney Airport Noise Insulation Project, was to be corporatised with a view to sale. AOSS was subsequently advertised for sale with the above businesses. Another business unit, the Australian Property Group (APG), was also offered for sale in 1997.

¹ The Department of Administrative Services (DAS) and Department of Finance (DOF) were reorganised in October 1997 to form the Department of Finance and Administration (DOFA). In this report the Department of Administrative Services and the Department of Finance will be referred to by their former names and acronyms.

4. The Office of Asset Sales and IT Outsourcing (OASITO)² was assisted in the DAS Business Unit sales by Deacons Graham and James as Legal Adviser³ and two Business Advisers, Baring Brothers Burrows & Co., Limited (referred to as Barings) for DASFLEET and Arthur Andersen Corporate Finance Pty Limited for all other DAS Business Units. The Business Advisers were primarily responsible for conducting scoping studies and implementing the approved sales strategies. The Legal Adviser assisted with the scoping study and sales process including due diligence activities and preparation of sale documentation.

5. ANAO audit activity focused on the sale of three DAS Business Units, namely, DASFLEET to Macquarie Fleet Leasing Pty Ltd for \$407.9 million, Works Australia to Gutteridge Haskins and Davey Pty Ltd for a purchase price of \$4.3 million, and DAS Interiors Australia to Interiors Australia Pty Ltd for \$100 000. These three sales were selected for audit because each had particular features which could identify lessons for future asset sales and inform better administrative practices. Separate audit reports have been produced for each of these sales (see Figure 1). This report focuses on the management of the overall sale process for all business units.

Figure 1
Audit scope and report structure



Source: ANAO.

² The Office of Asset Sales (OAS) was established in October 1996 to manage the Commonwealth Government's major asset sales, reporting directly to the Minister for Finance. In November 1997, information technology outsourcing functions formerly managed by the Office of Government Information Technology transferred to the OAS, which became the Office of Asset Sales and IT Outsourcing and is referred to as OASITO throughout this report.

³ Because of a possible conflict of interest, OASITO and its Legal Adviser agreed in April 1997 that the Legal Adviser should cease acting in relation to the sale of DAS Distribution. On the recommendation of Arthur Andersen Corporate Finance (the Business Advisor for the DAS Distribution sale), OASITO appointed Sharwood Eyres Wilkie (now Andersen Legal) to commence acting in respect of the DAS Distribution sale.

Audit conclusions

6. Between July and October 1997, sale contracts were signed for each of the eight former DAS commercial business units. The sales of DASFLEET, Works Australia and DAS Interiors Australia were completed broadly within the indicative sales timetable and the businesses were effectively maintained throughout the sales process. The 'clean break' approach adopted for employees of the businesses appropriately addressed the impact of the sales on the employees of the DAS businesses while maximising the commercial flexibility of the purchasers of the businesses post-sale.

Commonwealth proceeds

7. The sale of the eight former DAS commercial business units raised gross proceeds of \$437 million. After deducting OASITO's direct sale costs of \$6.5 million and business wind-down costs of \$81 million, net proceeds to the Commonwealth are estimated to be \$349 million. The majority of the sales proceeds were generated by the sale of one business unit, DASFLEET (sale proceeds of \$407.9 million). However, final proceeds will not be able to be determined until a dispute between the Commonwealth and the purchaser of DASFLEET about the completion accounts for the transaction is settled.

Outsourcing arrangements

8. Asset sales are invariably complex and resource intensive activities undertaken within tight time frames. Overall responsibility for the management and completion of the sales was assigned to OASITO. OASITO operates with relatively few staff and outsources extensively to advisers and other consultants to undertake asset sales. Three major contracts were let in connection with the DAS Business Unit sales, namely a Legal Adviser contract and two Business Adviser contracts. Expenditure on these advisers totalled \$5.15 million, or some four-fifths of OASITO's sale costs.

9. When selecting an adviser, identifying the proposal that offers the best value for money in particular circumstances depends on professional judgements about a range of criteria relating to performance, technical issues, financial issues, assessment of risk and valuation of benefits. Negotiation of fees after selection of consultants is permitted by the Commonwealth Procurement Guidelines. However, ANAO notes the Commonwealth's negotiating position is likely to be greater prior to the selection of consultants because there is competition in the selection process itself.

10. After selection, the Business Advisers were asked to submit a fixed fee for Phase 1 (scoping study) and an indicative fee for Phase 2 (the sale), which would be fully negotiated at the end of Phase 1. The fee arrangements negotiated by OASITO involved total maximum fees of \$3.4 million for both phases compared to the successful advisers' initial non-binding proposals for maximum fees of \$2.3 million. OASITO advised ANAO that the indicative Phase 2 fees provided a benchmark for Phase 2 fee negotiations and that it was not possible to lock in Phase 2 fees at the Phase 1 stage because one purpose of Phase 1 was to reveal the tasks and complexities of the sale process.

11. OASITO's Legal Adviser was appointed through a selection process similar to that used for the Business Advisers. Phase 1 (scoping study) fees were capped at \$595 000, well below Phase 1 prices proposed by the other shortlisted firms. OASITO negotiated Phase 2 fees with the Legal Adviser at the conclusion of Phase 1. Phase 2 fees of \$1.12 million were paid by OASITO to its Legal Adviser, compared to the November 1996 estimate of \$524 000. OASITO advised ANAO that

the detailed requirements were unclear until the scoping study was completed. The advisers were appointed, in part, to assist in defining the full scope of work.

Fee arrangements

12. Establishing an appropriate payment schedule assists effective contract management. To obtain the benefits of an appropriate framework, it is important that procedures be developed and implemented to manage expenditure against the terms of the contract. Adviser payments accorded with the contracts with the exception of \$311 000 paid to the Legal Adviser for increased scope of sale agreement negotiations with the DASFLEET purchaser and up to \$127 140 paid to the Legal Adviser for advice on a refinancing of DASFLEET.

13. The Legal Adviser's Phase 2 contract required payment for advice on both the sale and refinancing of DASFLEET only while both options were being pursued. OASITO advised the Legal Adviser on 15 August 1997 that payment would be made, in accordance with the contract, only for work actually undertaken. Therefore, the full fee would not be paid for the refinancing option because work on this option did not proceed past the point of evaluating refinancing proposals submitted by tenders. However, the Legal Adviser invoiced, and OASITO paid, full fees for both the sale and refinancing options after OASITO decided to pursue only the sale option. ANAO drew the apparent overpayment of up to \$127 140 to OASITO's attention on 2 December 1997. The Legal Adviser received written notification of the apparent overpayment from OASITO in July

1998. The Legal Adviser confirmed that an overpayment had been made later that month. OASITO and the Legal Adviser subsequently agreed that the amount of the overpayment was \$102 500 which was then paid to OASITO on 12 October 1998.

Administrative practices

14. ANAO considers that, for future asset sales, administrative procedures could be strengthened in the following areas:

- ***Competitive tendering and contracting:*** The level of effective competition for adviser roles can be enhanced by providing all potential advisers with a clear comprehensive statement of requirements and conducting competitive selection processes for all major phases of advisory contracts.
- ***Contract management:*** Developing and implementing systematic procedures to manage expenditure against the terms of the relevant contract would assist OASITO enhance the effectiveness of its contract management. Such an approach would facilitate rather than inhibit the sales process, particularly where timeframes and complexities accentuate the management task.

Recommendations

15. ANAO made two recommendations concerning competitive tendering and contracting processes and procedures to manage expenditure against contractual terms. OASITO agreed with qualifications to both recommendations.

Recommendations

Set out below are ANAO's recommendations arising from this report, with report paragraph references and abbreviated responses from OASITO. More detailed responses are shown in the body of the report together with the findings.

Recommendation No.1
Para 2.25 ANAO *recommends* that the Office of Asset Sales and IT Outsourcing increase the level of effective competition in future competitive tendering and contracting processes for advisers by:

- (a) providing all potential advisers with a clear comprehensive statement of requirements;
- (b) providing all shortlisted applicants with a draft contract which outlines the services to be provided and proposed distribution of risks and the respective responsibilities; and
- (c) where justified, conducting competitive selection processes for all major phases of advisory contracts.

OASITO: Agreed with qualifications.

Recommendation No.2
Para 2.37 ANAO *recommends* that the Office of Asset Sales and IT Outsourcing enhance the effectiveness of its contract management by developing and implementing appropriate procedures to manage expenditure more systematically against the terms of the relevant contract.

OASITO: Agreed with qualifications.

Audit Findings and Conclusions

1. Introduction

This chapter outlines the background to the sales of the DAS Business Units, the various sales objectives and audit approach.

Background

1.1 Following reviews of each of the then thirteen Department of Administrative Services (DAS) commercial business units, the Government announced in the August 1996 Budget the intended sale of six business units. The reviews considered whether each of the businesses should be retained within DAS in their current form or in an alternative form, be privatised, or be corporatised as a Government owned company. The six businesses were:

- DASFLEET, which provided passenger and general commercial vehicle leasing, rental and fleet management and maintenance services. An alternative to sale, that of refinancing the vehicles, was to be considered as part of the sale process;
- Asset Services, which was responsible for maintenance and repairs, minor property improvement and professional technical advice on facilities and related equipment;
- DAS Centre for Environmental Management (DASCEM), which was responsible for management of ozone depleting substances and environmental consulting services;
- DAS Distribution, which provided domestic freight, international freight and warehousing and distribution services;
- DAS Interiors Australia (DAS Interiors), which provided strategic advice and planning for accommodation, design/documentation and supervision of office fit-out and high-technology engineering services; and
- Works Australia, which provided project management, architectural and engineering design and documentation services.

1.2 In addition, Australian Operational Support Services (AOSS), which provided facilities support services and was prime contractor for the Sydney Airport Noise Insulation Project, was to be corporatised with a view to sale. AOSS was subsequently advertised for sale with the above businesses. Another business unit, the Australian Property Group (APG), was also offered for sale in 1997.

1.3 The Office of Asset Sales and IT Outsourcing (OASITO) was responsible for overall management and completion of the sales. Between July and October 1997, sale contracts were signed for each of the eight DAS commercial business units. The sales of DASFLEET, Works Australia and DAS Interiors (which were examined by ANAO) were completed broadly within the indicative sales timetable. As well, the businesses were effectively maintained throughout the sales process.

1.4 Gross total proceeds from the sales were in the order of \$437 million. After deducting OASITO's direct sale costs of \$6.5 million and business wind-down costs of \$81 million, net proceeds to the Commonwealth are estimated to be \$349 million.

Sales objectives

1.5 Formal objectives for the DAS sales were not developed although draft objectives were provided by OASITO to its Business and Legal Advisers at a planning forum in November 1996. OASITO has advised ANAO that the draft sales objectives provided to its advisers are an appropriate reference point for assessing the sales outcomes. The draft objectives were to:

- obtain a fair price for the businesses while considering the Government's social, industry, competition and fiscal/revenue policy objectives;
- take into account the impact on Australian industry;
- minimise the potential risk exposure to the Commonwealth, both as former owners of the businesses and as a future purchaser of services;
- take into account the Government's community and public interest obligations;
- take into account the impact on current employees of the DAS businesses;
- complete the sales in a timely manner;
- identify the key pitfalls early in the sales process;
- complete the sales with no residual businesses or business parts; and
- maintain the buoyancy of the businesses during the sales process.

Audit approach

1.6 The objectives for the audit were to review the efficiency and effectiveness of sale management as it related to the sales of DASFLEET, Works Australia and DAS Interiors. These three sales were selected for audit because each had particular features which could identify lessons for future asset sales and inform better administrative practices. DASFLEET was chosen in that it was the most significant sale with a purchase price of

some \$408 million. Works Australia was selected because of the ongoing contractual issues relating to private stewardship of prepaid Commonwealth funds and DAS Interiors because it involved a management buy out, a feature not present in Commonwealth asset sales considered by previous ANAO performance audits. Separate audit reports have been produced on the three sales. This report addresses overall management of the sales process for all business units.

1.7 The approach taken in the audit was to review data relating to the sales held by OASITO, its advisers and the Department of Finance and Administration (DOFA).⁴ Fieldwork and consultations were undertaken between October 1997 and September 1998. ANAO was assisted by advice from the Australian Government Solicitor on contract management issues. The audit was conducted in accordance with ANAO Auditing Standards at a cost to ANAO of \$63 000.

⁴ ANAO developed criteria which addressed the extent to which the Government's sales objectives were achieved; the management of the sales process including planning and preparation, coordination, contracting process and management; the tendering and tender evaluation process; and any ongoing issues post-settlement.

2. Sale Management

This chapter discusses the arrangements for the management of the sales of the DAS Business Units.

Background

2.1 Asset sales are invariably complex and resource intensive activities undertaken within tight time frames. OASITO operates with relatively few staff and outsources the sales processes extensively to its major advisers and other consultants. OASITO was assisted in the DAS Business Unit sales by Deacons Graham and James as Legal Adviser⁵ and two Business Advisers, Baring Brothers Burrows & Co., Limited (referred to as Barings) for DASFLEET and Arthur Andersen Corporate Finance Pty Limited for all other DAS Business Units. The Business Advisers were primarily responsible for conducting scoping studies and implementing the approved sales strategies. The Legal Adviser assisted with the scoping study and sales process including due diligence activities and preparation of sale documentation.

2.2 A Steering Committee, chaired by OASITO, was established to oversee the sales. The Legal, Business and Communications Advisers and senior staff from DAS were represented on the Committee.⁶ The Business Advisers, Legal Adviser and DAS were required to provide the Committee with regular progress reports on sale preparation. Meetings were held from December 1996 to provide updates on the progress of the planning and execution of the sales, including due diligence, and to assist in prompt decision making in relation to the due diligence process and preparation of the information memoranda.

2.3 The 'clean break' approach meant that all employees who were excess to requirements could elect to finish their employment at the time

⁵ Because of a possible conflict of interest, OASITO and its Legal Adviser agreed in April 1997 that the Legal Adviser should cease acting in relation to the sale of DAS Distribution. On the recommendation of Arthur Andersen Corporate Finance, OASITO appointed Sharwood Eyres Wilkie (now Andersen Legal) to commence acting in respect of the DAS Distribution sale.

⁶ The Committee's terms of reference included: identifying, reviewing and resolving relevant policy decisions; ensuring the information memoranda and data packs contained no material omissions or false or misleading statements; and ensuring the information memoranda included all information that purchasers and their professional advisers would reasonably require and reasonably expect to find to make an informed assessment of the assets and liabilities, financial position, profits and losses and prospects of the business units.

the businesses were sold or move to a redeployment unit within DAS.⁷ Employees who elected to finish their employment were paid out all of their leave entitlements and received a redundancy package regardless of whether they were then employed by the new Business Unit owners. The new owners were free to employ any ex-employees they wished, were unconstrained in setting employment terms and conditions and there was no carry over of entitlements.

2.4 Finding: The ‘clean break’ approach adopted for employees of the businesses appropriately addressed the impact of the sales on the employees of the DAS businesses while maximising the commercial flexibility of the purchasers of the businesses post-sale.

Sale completion

2.5 The sale of specified assets and liabilities of eight DAS commercial business units raised gross proceeds of \$437 million with the majority of the sales proceeds, \$407.9 million, generated by the sale of DASFLEET. Shortlisted bidders were provided with an asset and liability statement on which to base their bids with the purchase price offered to be adjusted for differences between that statement and a further statement prepared at sale completion. ANAO was engaged to audit both statements for all businesses.⁸

2.6 The purchase prices of five of the businesses were adjusted following the preparation of completion accounts with the result that, in four sales, the Commonwealth made adjustments in favour of the purchaser and, in one sale, the adjustment made favoured the Commonwealth. These sale adjustments are outlined in Figure 2.1.

2.7 OASITO is in dispute with the purchaser of DASFLEET over the net asset position set out in the completion asset and liability statement and the adjustment made by OASITO to the purchase price. OASITO has sought a further payment from the purchaser of DASFLEET based on DASFLEET completion accounts. On 2 June 1998, OASITO received written notice from the purchaser of a dispute under clause 25 of the Sale Agreement concerning the DASFLEET completion accounts.

⁷ The alternative to a ‘clean break’ approach is a negotiated transfer where the sale is on the condition that staff, to the maximum extent possible, are transferred with their pay and conditions to the buyer.

⁸ ANAO issued unqualified audit opinions on both statements but included an emphasis of matter paragraph in the DASFLEET audit report drawing users’ attention to the inherent uncertainty regarding the recoverable amount of the vehicle fleet (the recoverable amount equals net cash flow expected from the continued use and subsequent disposal of the asset).

Figure 2.1**Sale Proceeds as at June 1998**

Business Units	Initial Proceeds	Sale Adjustment	Adjusted Sale Proceeds
	\$m^a	\$m	\$m
DASFLEET	407.901	n.a. ^b	407.901 ^b
Asset Services	18.483	0.214	18.697
Works Australia	4.323	(0.133)	4.189
Australian Property Group	3.877	(1.002)	2.875
Australian Operational Support Services	2.050	(0.070)	1.980
DAS Distribution	1.125	(0.159)	0.966
DAS Interiors	0.100	Nil	0.100
DAS Centre for Environmental Management	0.014	Nil	0.014
TOTAL	437.873	(1.15)	436.722
Notes:	^a Proceeds prior to the finalisation of any asset and liability statement adjustments. ^b Currently in dispute.		

Source: Information provided by OASITO

2.8 The Commonwealth's direct costs of selling the businesses are estimated to be \$6.53 million or 1.5 per cent of gross proceeds (see Figure 2.2). In addition, the wind-down costs incurred by DOFA amount to some \$81 million of which \$54 million related to staff redundancy costs.⁹ The latter was required by the 'clean break' approach adopted for employees of the business units.

2.9 Finding: The sale of eight DAS commercial business units raised gross proceeds of \$437 million. After deducting OASITO's direct sale costs of \$6.5 million and business wind-down costs of \$81 million, net proceeds to the Commonwealth are estimated to be \$349 million. The majority of the sales proceeds were generated by the sale of one business unit, DASFLEET (sale proceeds of \$407.9 million). However, final proceeds will not be able to be determined until a dispute between the Commonwealth and the purchaser of DASFLEET about the completion accounts for the transaction is settled.

⁹ These costs included actual redundancy costs and payment of accrued leave entitlements.

Figure 2.2
Sales Proceeds and Costs as at June 1998

	\$m ^a	\$m ^a
• Adjusted Sale Price		
Purchase prices		
DASFLEET	407.90	
Asset Services	18.70	
Works Australia	4.19	
Australian Property Group	2.88	
Australian Operational Support Services	1.98	
DAS Distribution	0.97	
DAS Interiors	0.10	
DAS Centre for Environmental Management	0.01	
Gross Proceeds	<u> </u>	436.73
• OASITO Costs		
Business advisers	3.11	
Legal advice ^b	2.23	
Running costs ^c	0.25	
Other	0.94	
Total OASITO costs	<u> </u>	6.53
• DOFA Wind-down expenses		
Staff redundancy ^d	54.01	
Running costs	1.06	
Management buy outs ^e	0.39	
Business Closures Section ^f	25.45	
Total DOFA costs	<u> </u>	80.91
Direct Sales Costs		87.44
• Estimated Net Proceeds		349.31
Note:		
^a Figures have been subject to rounding.		
^b Legal costs adjusted by \$102 500. The Legal Adviser repaid this amount (which was previously overpaid by OASITO) to the Commonwealth on 12 October 1998 (see para 2.35).		
^c Excludes labour on costs which, according to Department of Finance Guidelines, average 154.4 per cent of the salary costs.		
^d Includes cost of voluntary redundancies at the time of the sale but excludes voluntary redundancies subsequent to the sale and costs related to staff transferring to the Staff Redeployment Unit.		
^e The Government agreed to provide funding of up to \$600 000 for advice to assist management buy out teams.		
^f Within DOFA, the Business Closures section is responsible for activities associated with the close down of the DAS businesses including the preparation of financial statements at the date of each sale.		

Source: ANAO analysis based on information provided by DOFA and OASITO.

Outsourcing arrangements

2.10 The principles and policies of Commonwealth procurement are outlined in the Commonwealth Procurement Guidelines. They include the achievement of value for money; open and effective competition; ethics and fair dealing; and accountability. Commonwealth officers are required to have regard to the Commonwealth Procurement Guidelines when contracting for professional and other consultancy services, including outsourcing and contracting out activities.¹⁰

2.11 In the appropriate circumstances, the use of competitive tendering and contracting promotes open and effective competition by calling for offers which can be evaluated against clear and previously stated requirements to obtain value for money. This in turn creates the necessary framework for a defensible, accountable method of selecting a service provider. One of the most important elements of competitive tendering and contracting is planning and designing the request for proposal document. Sound administrative practice suggests that requests for proposals should include a clear comprehensive statement of requirements which will form the basis of the eventual contractual relationship¹¹ and that the contracting process should be conducted in a manner that encourages a competitive field and assists with comparing bids against the selection criteria.

2.12 Identifying the proposal that offers the best value for money in particular circumstances depends on professional judgements about a range of criteria relating to performance, technical issues, financial issues, assessment of risk and valuation of benefits. Negotiation of fees after selection of consultants is permitted by the Commonwealth Procurement Guidelines. However, ANAO notes the Commonwealth's negotiating position is generally likely to be greater prior to the selection of consultants because there is competition in the selection process itself.

¹⁰ Finance Regulation 42, which was in place until 31 December 1997, refers. Since 1 January 1998, Financial Management and Accountability Regulation 8 has imposed the same requirement.

¹¹ The Industry Commission's Report No. 48 *Competitive Tendering and Contracting by Public Sector Agencies* identified a number of risks to achieving value for money if tenders do not reflect the full scope of requirements:

- incumbency advantages may reduce the level of competition for later phases of a contract as a result of the existing supplier having greater information and knowledge about the next stage of the task;
- 'loss leading' can occur whereby a potential supplier prices its tender below short-run marginal costs in an attempt to win the initial contract with the expectation of recouping the losses over the full period of the contract; and
- post-tender negotiations, and other actions which may change the scope of the contract after the initial tender, can lead to perceptions that fair and open competition did not occur.

Business Advisers

2.13 In September 1996, 36 advisory firms were invited to submit a proposal for the conduct of, and reporting on, scoping studies relating to the proposed sales (Phase 1) and the sale of the Business Units (Phase 2), on the basis established by the scoping studies and agreed by the Government. Respondents were asked to include an indicative non-binding price in their proposals. The criteria used to develop the shortlist were relevant experience; specific knowledge of the businesses and/or the wider business sector in which they operate; the level of understanding of the work; and the quality and depth of resources available to undertake the task.

2.14 A two phase selection process was adopted with written proposals used to draw up a short list for interviews. Of the 36 firms approached, 16 submitted proposals and six were shortlisted for interview by a selection panel comprising a representative from each of OASITO and DAS as well as two private sector representatives. As a result of the interviews, in November 1996 the panel recommended the appointment of Barings as Business Adviser for the DASFLEET sale and Arthur Andersen Corporate Finance as Business Adviser for the sales of the remaining Business Units. The panel considered dividing the consultancy in this manner offered the best value for money.

2.15 The tender evaluation process and interviews focused on Phase 1 tasks and fees although Phase 2 was likely to be more resource intensive and costly. The Phase 1 Business Adviser contracts reflected this emphasis and did not include fees for Phase 2. OASITO advised ANAO that the fact that *Phase 2 fees were later to be negotiated was an implicit part of the strategy.*

2.16 After selection, OASITO provided updated and more detailed information on its requirements and invited the newly selected Business Advisers to review their resource requirements and fees to reflect the revised requirements. The Business Advisers were asked to submit a fixed fee for Phase 1 and an indicative fee for Phase 2. They submitted proposals involving higher fees than proposed in their initial submissions. However, the panel considered that the resources proposed for the tasks were not over generous and were offset by reduced proposed fees for Phase 2. OASITO advised ANAO that *the detailed requirements were unclear until the scoping study was completed. The advisers were appointed, in part, to assist in defining the full scope of work.*

2.17 OASITO sought from each Business Adviser at the conclusion of Phase 1 a fee quote for Phase 2. This decision was consistent with the request for proposals which had informed potential advisers that, subject to satisfactory performance and the Commonwealth's discretion to re-

tender the consultancy, the Business Adviser selected for Phase 1 would execute the sales strategy. The negotiation process was protracted, particularly with respect to fee arrangements. Negotiations commenced in February 1997 but contract amendments were not finalised until late June 1997. The fee arrangements negotiated by OASITO involved total maximum fees of \$3.4 million for both phases compared to the successful advisers' initial non-binding proposals for maximum fees of \$2.3 million. OASITO advised ANAO that the indicative Phase 2 fees provided a benchmark for Phase 2 fee negotiations and that it was not possible to lock in Phase 2 fees at the Phase 1 stage because one purpose of Phase 1 was to reveal the tasks and complexities of the sale process.

2.18 Finding: After selection, the Business Advisers were asked to submit a fixed fee for Phase 1 (scoping study) and an indicative fee for Phase 2 (the sale process), which would be fully negotiated at the end of Phase 1. The fee arrangements negotiated by OASITO involved total maximum fees of \$3.4 million for both phases compared to the successful advisers' initial non-binding proposals for maximum fees of \$2.3 million. OASITO advised ANAO that the indicative Phase 2 fees provided a benchmark for Phase 2 fee negotiations and that it was not possible to lock in Phase 2 fees at the Phase 1 stage because one purpose of Phase 1 was to reveal the tasks and complexities of the sale process.

Legal Adviser

2.19 On 27 September 1996, OASITO invited eight firms to submit a proposal to act as legal adviser to assist OASITO and its Business Advisers with legal aspects of the scoping studies and subsequent sales. The eight firms were selected from a register of consultants compiled following advertisements in the national press in December 1995. A further firm, not then on the register, inquired about the sales and was also invited to submit a proposal.

2.20 The written proposals (including indicative, non-binding prices) of the six respondents were assessed against the criteria advised to the firms in the request for proposals namely, relevant experience, level of understanding, and the quality and depth of resources available to undertake the task. Three firms were shortlisted for interview by a panel comprising a representative from each of OASITO and DAS as well as two private sector representatives.

2.21 Based on a more detailed description of the task provided during the interviews, each shortlisted firm was asked to submit a fixed fee for Phase 1 and an indicative fee for Phase 2. After considering the supplementary proposals, the panel decided to explore the preferred proposal further. An updated proposal was received from the preferred

adviser. The updated proposal involved increased fees following the removal by the preferred adviser of a number of qualifications from its original proposal and an improvement in the availability of key senior lawyers. The panel recommended the preferred adviser's updated proposal be accepted with Phase 1 fees capped at \$595 000, well below Phase 1 prices proposed by the other shortlisted firms.

2.22 The panel's evaluation of the proposals focused on Phase 1 of the sales and gave limited attention to the more involved and costly Phase 2, although the request for proposals stated that the initial selection could be extended to encompass Phase 2. OASITO advised ANAO that this approach *recognised that the full scope of Phase 2 work would not be known until Phase 1 had been completed. Any fee proposals for Phase 2 were clearly indicative only at that stage.*

2.23 OASITO decided not to conduct a separate competitive contracting process for Phase 2 of the legal adviser consultancy and negotiated fee arrangements with the incumbent Legal Adviser. The Phase 2 contract provided for a maximum payment of \$612 775¹² compared to the estimate of \$524 000 advised to OASITO in November 1996. Phase 2 fees of \$1.12 million were paid by OASITO to its Legal Adviser for advice on the sale of the six businesses included in the November 1996 fee estimate.¹³ Increased fees were paid for the increased scope of work undertaken, particularly in relation to the DASFLEET sale.

2.24 Finding: OASITO's Legal Adviser was appointed through a selection process similar to that used for OASITO's Business Advisers. Phase 1 (scoping study) fees were capped at \$595 000, well below Phase 1 prices proposed by the other shortlisted firms. OASITO negotiated Phase 2 fees with the Legal Adviser at the conclusion of Phase 1. Phase 2 fees of \$1.12 million were paid by OASITO to its Legal Adviser, compared to the November 1996 estimate of \$524 000. OASITO advised ANAO that *the detailed requirements were unclear until the scoping study was completed. The advisers were appointed in part, to assist in defining the full scope of work.*

¹² Adjusted to include fees for the Works Australia, DAS Interiors, Asset Services, DASCEM, DAS Distribution and DASFLEET sales. Fees for AOSS and APG sales were excluded as they were not included in the initial request for proposals.

¹³ In addition, Phase 2 fees of \$144 620 were paid in relation to the sales of AOSS and APG. Phase 2 fees for these two sales were not included in the November 1996 fee estimate.

Recommendation No. 1

2.25 ANAO *recommends* that the Office of Asset Sales and IT Outsourcing increase the level of effective competition in future competitive tendering and contracting processes for advisers by:

- (a) providing all potential advisers with a clear comprehensive statement of requirements;
- (b) providing all shortlisted applicants with a draft contract which outlines the services to be provided and proposed distribution of risks and the respective responsibilities; and
- (c) where justified, conducting competitive selection processes for all major phases of advisory contracts.

OASITO response

2.26 OASITO's response was that it ***agreed with qualifications*** to the recommendation. OASITO noted that in many real-world situations the approach recommended by ANAO will simply be unworkable and inconsistent with the use of outsourced expert advisers to undertake both scoping studies and sale execution. It casts advisers only as contractors engaged to deliver a specified output. OASITO engages outsourced advisers on a wider basis, consistent with government policy on the administration of asset sales.

2.27 As to (a) and (b), OASITO notes that the arrangement outlined by ANAO can only apply where there is a high degree of certainty at the outset as to the detailed requirements and necessary contractual terms. The purpose of a scoping study is often to develop the basis for preparation of these requirements.

2.28 As to (c), it is often not practicable to conduct separate competitive selection exercises for advisers for second or subsequent phases of an assignment. This is because of time constraints, because competitors have often by that time been engaged by potential bidders (for trade sales), or because it would not be cost-effective for a replacement adviser to replicate the incumbent adviser's learning curve on the project. In such cases, the competitive selection for the first phase must also serve as the selection of the adviser for subsequent phases of the project.

2.29 But in such cases, it is simply not possible at that stage to also provide the potential advisers with a *clear comprehensive statement of requirements*. This is because the work to define that statement forms the brief for the first phase. This requires direct negotiation of the terms of engagement for the second and subsequent stages once the requirements are agreed. OASITO accepts that it should, where foreseeable, ensure that

selection exercises for scoping study work identify that it is expected that the engagement will be extended by direct negotiation to subsequent phases.

ANAO comment

2.30 A staged procurement approach, involving a planned and structured series of selection processes, can be useful in asset sales that commence with a scoping study to develop recommendations on the preferred way to proceed. The experience gained by the incumbent advisers through the scoping study, and any work undertaken before formally re-appointing the advisers for the sale process, can place OASITO at some disadvantage in negotiating appropriate contractual and fee arrangements for the sale process. In circumstances where OASITO considers that it is not practicable to conduct separate competitive selection exercises for the subsequent phases of sale processes, it is particularly important that OASITO's procurement approach maximises the level of effective competition in the initial selection exercise and that negotiations on terms and conditions for any re-appointment be timely and transparent.

Contract management

2.31 Establishing an appropriate payment schedule assists effective contract management. To obtain the benefits of an appropriate framework, it is important that procedures be developed and implemented to manage expenditure against the terms of the contract. Adviser payments accorded with the contracts with the exception of \$311 000 paid to the Legal Adviser for increased scope of sale agreement negotiations with the DASFLEET purchaser and up to \$127 140 paid to the Legal Adviser for advice on a refinancing of DASFLEET.

2.32 The Legal Adviser's Phase 2 contract required payment for advice on both the sale and refinancing of DASFLEET only while both options were being pursued. OASITO advised the Legal Adviser on 15 August 1997 that payment would be made, in accordance with the contract, only for work actually undertaken. Therefore the full fee would not be paid for the refinancing option because work on this option did not proceed past the point of evaluating refinancing proposals submitted by tenderers (refinancing was assessed to be uncompetitive on price compared to an outright sale). However, the Legal Adviser invoiced, and OASITO paid, full fees for both the sale and refinancing options after OASITO decided to pursue only the sale option.¹⁴

¹⁴ OASITO paid \$84 760 on 20 August 1997 and \$42 380 on 28 October 1997.

2.33 The apparent overpayment of up to \$127 140 was identified by ANAO and drawn to OASITO's attention on 2 December 1997. ANAO identified work possibly not undertaken on the refinancing option to the value of \$127 140 based on contract milestones not reached.

2.34 The ANAO was advised by the Legal Adviser that it received notification from OASITO in July 1998 of this matter. The Legal Adviser advised OASITO on 22 July 1998 that:

It appears we have inadvertently invoiced the Office of Asset Sales and IT Outsourcing for an amount in excess of the amount relevant to the Consultancy Agreement. We are currently reviewing the matter and specifically the timing of the refinancing work and will contact you shortly in relation to the amount to be refunded.

2.35 OASITO advised ANAO on 11 August 1998 that its Legal Adviser had agreed to repay an amount in respect of the overpayment with the specific amount yet to be agreed. After discussions about which activities had been performed, the settlement amount of \$102 500 was agreed between OASITO and the Legal Adviser. On 12 October 1998, the Legal Adviser paid this amount.

2.36 Finding: The Legal Adviser's Phase 2 contract required payment for advice on both the sale and refinancing of DASFLEET only while both options were being pursued. OASITO advised the Legal Adviser on 15 August 1997 that payment would be made, in accordance with the contract, only for work actually undertaken. Therefore the full fee would not be paid for the refinancing option. However, the Legal Adviser invoiced, and OASITO paid, full fees for both the sale and refinancing options after OASITO decided to pursue only the sale option. ANAO drew the apparent overpayment of up to \$127 140 to OASITO's attention on 2 December 1997. In July 1998, the Legal Adviser confirmed the overpayment. OASITO and the Legal Adviser subsequently agreed that the amount of the overpayment was \$102 500 which was then paid to OASITO on 12 October 1998.

Recommendation No. 2

2.37 ANAO *recommends* that the Office of Asset Sales and IT Outsourcing enhance the effectiveness of its contract management by developing and implementing appropriate procedures to manage expenditure more systematically against the terms of the relevant contract.

OASITO response

2.38 OASITO's response was it **agreed with qualifications** to the recommendation. OASITO advised that the OASITO Chief Executive's Instructions have been amended to provide additional guidance on the

scrutiny of invoices in the light of this type of issue. But it is unrealistic to aim to eliminate all human error and oversight, nor is it cost effective to do so.

ANAO comment

2.39 The reimbursement of \$102 500 in respect of a contractual overpayment highlights the need for effective management of contract payments by OASITO. ANAO recognises that it is unrealistic to expect that all human error can be eradicated from any administrative process. However, on two separate occasions payments were made to one of OASITO's prime contractors that were not required under the terms of the contract. This indicates there is scope for OASITO to develop sound administrative procedures that ensure significant claims by its major contractors are subject to appropriate scrutiny, consistent with a sound risk management approach. Thus, appropriate assurance can be provided to all stakeholders both in terms of sound process and cost effective outcomes.

Canberra ACT
18 December 1998



P. J. Barrett
Auditor-General

