

The Auditor-General

Audit Report No.26

Performance Audit

Sale of Works Australia

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 sale of Works Australia 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 *Sale of Works Australia*.

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, which appears to read 'P. J. Barrett', is positioned below the text 'Yours sincerely'.

P. J. Barrett
Auditor-General

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

AUDITING FOR AUSTRALIA

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

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Abbreviations/Glossary

ANAO	Australian National Audit Office
CPA	Commonwealth Public Account
DAS	Former Department of Administrative Services
DOF	Former Department of Finance
DOFA	Department of Finance and Administration
OASITO	Office of Asset Sales and IT Outsourcing
Works	Works Australia

Summary and Recommendations

Summary

Background

1. Works Australia (hereafter referred to as 'Works') was a Commonwealth owned and operated business that provided project, architectural and engineering design and documentation services to the Commonwealth and State Governments and private enterprise. Works was sold in August 1997 to Gutteridge Haskins & Davey Pty Ltd for a purchase price of \$4.3 million. Works was one of eight former Department of Administrative Services (DAS) commercial business units sold in 1997.
2. Overall responsibility for the management and completion of the sale was assigned to the Office of Asset Sales and IT Outsourcing (OASITO).¹ OASITO was assisted in the Works sale by a Business Adviser and a Legal Adviser. The Business Adviser was primarily responsible for conducting a scoping study and implementing the approved sale strategy. The Legal Adviser assisted with the scoping study and sale process including due diligence activities and preparation of sale documentation.
3. The sale of Works was selected for audit because of the ongoing contractual issues relating to private stewardship of prepaid Commonwealth funds. ANAO also audited the sale of DASFLEET and the sale of DAS Interiors Australia. Separate audit reports have been produced on overall sale management; the DASFLEET sale; and the DAS Interiors Australia sale.

Audit conclusions

4. The Minister for Finance was advised of the preferred tenderer for Works in June 1997. The Sale Agreement was signed on 17 July 1997 with the purchase price paid on 14 August 1997. The Works sale was substantially completed in accordance with the sale timetable which had planned for sale completion by 30 June 1997.
5. A staged bidding approach was adopted for the sale of Works. Ten Expressions of Interest were received and seven of these were shortlisted. Four conforming tenders were received for the purchase of Works. The tender evaluation criteria advised to shortlisted bidders were then applied

¹ 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 will be referred to as OASITO throughout this report.

in the assessment of tenders with the successful tenderer assessed as being equal or superior to all other bidders on all evaluation criteria including offering the highest purchase price of \$4.3 million. The price compares favourably to the net assets sold and the Business Adviser's initial proceeds estimates.

6. A large number of Works' Commonwealth clients had advanced funds (client advances) to Works in connection with various projects. At the time of sale, client advances amounted to \$45.3 million, comprising \$30.5 million from Commonwealth Public Account (CPA) agencies and \$14.8 million from non-CPA clients. Works was offered for sale on the basis that the client advances, which comprised the majority of Works' assets, would be assigned in trust to the new owners. This made the business more attractive to potential purchasers.

7. The commercial risk environment for public sector customers changes when a public sector provider is replaced by private sector providers that generally have a higher commercial risk than public sector providers. OASITO decided that the advances would be transferred to the new owners without undertaking a detailed assessment of the changed commercial environment including analysing alternatives to transferring the advances to the new owners. In addition, OASITO and its advisers did not address the practicalities of transfer prior to bids closing. The arrangements implemented were proposed by the purchaser and agreed to by OASITO. ANAO considers that the Commonwealth's overall position in future trade sales involving the possible transfer of stewardship responsibility for significant Commonwealth funds to the private sector could be enhanced by OASITO undertaking an assessment of the changed commercial environment, before deciding on the post-sale arrangements.

Recommendations

8. ANAO made one recommendation aimed at maximising the Commonwealth's overall position in future trade sales involving the possible transfer of stewardship responsibility for significant Commonwealth funds to the private sector. OASITO agreed with qualifications to the recommendation.

Recommendation

Set out below is ANAO's recommendation arising from this report, with the report paragraph reference and OASITO's response.

- Recommendation No.1**
Para 1.17
- ANAO *recommends* that the Office of Asset Sales and IT Outsourcing maximise the Commonwealth's overall position in future trade sales involving the possible transfer of stewardship responsibility for significant Commonwealth funds to the private sector by:
- (a) identifying at an early stage in the sale process those issues that may impact on the Commonwealth's post-sale exposure; and
 - (b) undertaking an assessment of the optimal approach to post-sale stewardship of Commonwealth funds, before deciding on the post-sale arrangements.
- OASITO:** Agreed with qualifications.

Audit Findings and Conclusions

1. Sale of Works Australia

This chapter outlines the sale process for Works Australia.

Background

1.1 Works Australia² (hereafter referred to as 'Works') was a Commonwealth owned and operated business that provided project, architectural and engineering design and documentation services to the Commonwealth and State Governments and private enterprise. Following reviews of each of the then thirteen Department of Administrative Services (DAS)³ commercial business units, the Government announced in the August 1996 Budget the intended sale of six of the then eight business units, including Works. Works was sold in August 1997 to Gutteridge Haskins & Davey Pty Ltd for a purchase price of \$4.3 million.

1.2 Works earned almost \$35 million operating revenue in the thirteen months to 31 January 1997 and an operating profit before abnormal items of \$1.5 million. Total assets as at 31 January 1997 were \$28 million with liabilities of \$30 million resulting in negative shareholder's equity of \$2 million. The majority of Works' assets were client cash advances (\$18 million as at 31 January 1997 and \$45 million by August 1997). It had an office in every Australian capital city and, as at 7 March 1997, had 177 staff not including 27 staff from the then DAS who provided a total corporate support package.

Audit approach

1.3 The objectives for the audit were to examine the efficiency and effectiveness of the conduct of the sales process for Works. The approach taken in the audit was to review data relating to the sale held by OASITO, its advisers, and DOFA. Accordingly, ANAO conducted fieldwork and consultations between October 1997 and September 1998 at DOFA, OASITO and its Business and Legal Advisers.⁴ The audit was conducted in accordance with ANAO Auditing Standards at a cost to ANAO of \$53 000.

² Established in January 1996 out of a predecessor business, the Australian Construction Services.

³ 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 ANAO developed criteria which addressed whether the Government's sale objectives were achieved; the management of the sale process including planning and preparation, coordination, contracting process and management; the tendering and tender evaluation process; and any ongoing issues post-settlement.

1.4 The sale of Works was selected for audit because of the ongoing contractual issues relating to private stewardship of prepaid Commonwealth funds. ANAO also audited the sale of DASFLEET and the sale of DAS Interiors Australia. Separate audit reports have been produced on overall sale management; the DASFLEET sale; and the DAS Interiors Australia sale.

Sale management

1.5 Overall responsibility for the management and completion of the sale was assigned to the Office of Asset Sales and IT Outsourcing (OASITO). OASITO was assisted in the Works sale by Arthur Andersen Corporate Finance Pty Limited as Business Adviser and Deacons Graham and James as Legal Adviser. The Business Adviser was primarily responsible for conducting a scoping study and implementing the approved sale strategy. The Legal Adviser assisted with the scoping study and sale process including due diligence activities and preparation of sale documentation.

1.6 Formal objectives for the DAS Business Unit 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 sale 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 owner 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.

1.7 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.⁵ 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.

Sale process

1.8 OASITO and the Business Adviser adopted a staged bidding approach for the sale of Works. Figure 1.1 outlines the major stages, the progressive shortlisting of bidders and the time taken compared with the planned timetable. Sale completion was planned to occur by 30 June 1997. The Minister for Finance was advised of a preferred tenderer in June 1997. The Sale Agreement was signed on 17 July 1997 with the purchase price paid on 14 August 1997.

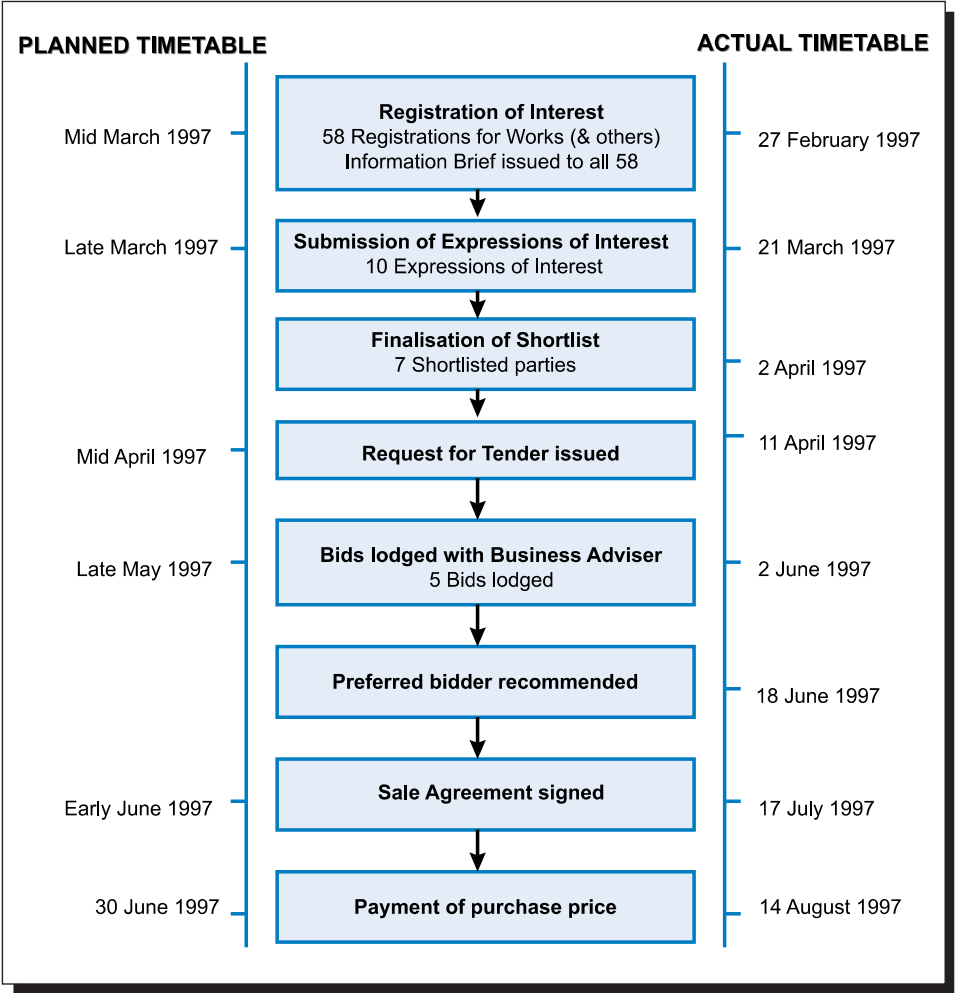
1.9 Ten parties submitted an Expression of Interest in Works. Four of these also expressed interest in one or more of the other DAS businesses and one lodged a combination Expression for Works and DAS Interiors Australia. The Business Adviser analysed the information provided by each proponent and recommended that seven parties be shortlisted. Shortlisted parties were provided with confidential due diligence information and the Request for Tender which specified the requirements for the preparation and lodgement of offers and outlined the evaluation criteria.

1.10 Five of the seven shortlisted parties submitted an offer. One of the five tenders did not conform with the requirements⁶ and was not evaluated. The remaining four tenders were evaluated by the Business Adviser using a scoring approach that applied equal weighting to each of the tender evaluation criteria. On 18 June 1997, the Business Adviser recommended Gutteridge Haskins & Davey Pty Ltd be selected as preferred tenderer for Works Australia. Its offer was assessed as equal or superior to other tenders on all criteria and overall it scored significantly higher than the other tenders.

⁵ 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.

⁶ The tender did not offer a price and indicated an offer to negotiate only.

Figure 1.1:
Tender Process



Source: ANAO analysis of information provided by OASITO.

1.11 The successful bidder offered the highest purchase price. The price compares favourably to the April 1997 estimate of post-sale net assets of \$3.75 million and to the Business Adviser’s initial proceeds estimates.

1.12 Finding: The sale was substantially completed in accordance with the sale timetable with the Sale Agreement signed on 17 July 1997. The tender evaluation criteria advised to shortlisted bidders were applied in the assessment of tenders. The tender evaluation process included the assignment of priorities with equal weighting given to each evaluation criterion. The successful tenderer was assessed as being equal or superior to all other bidders on all evaluation criteria including offering the highest

purchase price of \$4.3 million. The price compares favourably to the April 1997 estimate of post-sale net assets of \$3.75 million and the Business Adviser's initial proceeds estimates.

Client advances

1.13 In deciding to sell the businesses, the Government specified that all existing Memoranda of Understanding between the business units and their Commonwealth agency clients should be converted to binding contracts at the point of sale, providing obligations on the purchaser to complete the obligations of the business units. A large number of Commonwealth clients had advanced funds (client advances) to Works in connection with various projects.⁷

1.14 Works was offered for sale on the basis that the client advances would be assigned in trust to the new owners. This meant that the business was more attractive to potential purchasers. ANAO did not locate evidence of analysis by OASITO or its advisers of alternative arrangements which may have enhanced the overall position of the Commonwealth.⁸ This analysis could have encapsulated assessment of:

- the merits of repaying the money to Commonwealth clients rather than transferring the money to the new owner;
- the appropriate level of security over advances provided by Commonwealth Public Account (CPA) and non-CPA customers, given the post-sale arrangements were with a private sector service provider; and
- any trade-off between increased security over funds protected by a bank guarantee and interest revenue foregone through the purchaser retaining the interest on client advances protected by a bank guarantee.

1.15 Post-sale treatment of client advances was not identified and progressed as a major sale issue early in the sale process.⁹ As a result, provisions were not introduced to the Works sale agreement until shortly before the sale agreement was signed. Late in the sale process, OASITO, in consultation with its advisers and the then Department of Finance, developed a general approach to post-sale treatment of the client advances.

⁷ 'Client advances' refers to the situation where Works acts as agent between the client agency and the firm who actually undertakes the contracted work (that is, Works is acting as a project or program manager) and Works does not own the money at any point in time. Advances are distinguished from prepayments where Works is prepaid by its client for work it will undertake.

⁸ OASITO advised ANAO that: *OASITO and its advisers considered the issue of client advances. Bank guarantees would not have been forthcoming without the interest trade-off. This would have required the return of these advances. The possibility of repaying client advances, while possible, would have been likely to be disruptive both to the client and to the running of Works.*

⁹ OASITO advised ANAO that it *accepts that more work should have been done at an earlier stage.*

Consistent with this approach, the purchaser proposed, and OASITO agreed to, the following detailed procedures for the treatment of client advances:

- Advances from clients operating on the CPA (\$30.5 million at sale date) were assigned to the purchaser and protected by the purchaser providing a bank guarantee which diminishes as the level of client advances diminishes. The advances were transferred from an existing Commonwealth trust account and deposited in an interest-bearing bank account of the purchaser with the interest on the moneys retained by the purchaser to cover the cost of maintaining the bank guarantee. The purchaser also agreed to provide clients with a monthly statement and undertake a quarterly audit of the advances to ensure advances have been properly recorded and disbursed.
- Advances from clients not operating on the CPA (\$14.8 million as at 25 August 1997) were to be assigned only where express consent was given by clients, otherwise the advances were to be returned. The assigned advances from these clients were transferred from a Commonwealth trust account to a trust account of the purchaser with only senior personnel of the purchaser able to operate the account. They were not secured by a bank guarantee because the purchaser would not be able to recover the cost of maintaining a guarantee as the clients retain the interest on the advances.¹⁰ Quarterly audits of payments and operation of the trust account were to be undertaken. The purchaser would charge a fee of between 0.75 per cent and 1.25 per cent of the client advances to cover its costs for handling and investing the client advances.

1.16 Finding: The commercial risk environment for public sector customers changes when a public sector provider is replaced by private sector providers that generally have a higher commercial risk than public sector providers. OASITO decided that the advances would be transferred to the new owners without undertaking a detailed assessment of the changed commercial environment including analysing alternatives to transferring the advances to the new owners. In addition, OASITO and its advisers did not address the practicalities of transfer prior to bids closing. The arrangements implemented were proposed by the purchaser and agreed to by OASITO. ANAO considers that the Commonwealth's overall position in future trade sales involving the possible transfer of stewardship responsibility for significant Commonwealth funds to the private sector could be enhanced by OASITO undertaking an assessment of the changed commercial environment, before deciding on the post-sale arrangements.

¹⁰ On 18 July 1997, the Legal Adviser advised the Business Adviser that the trust account arrangement provided some protection in the event of insolvency but otherwise the funds are unsecured.

Recommendation No. 1

1.17 ANAO *recommends* that the Office of Asset Sales and IT Outsourcing maximise the Commonwealth's overall position in future trade sales involving the possible transfer of stewardship responsibility for significant Commonwealth funds to the private sector by:

- (a) identifying at an early stage in the sale process those issues that may impact on the Commonwealth's post-sale exposure; and
- (b) undertaking an assessment of the optimal approach to post-sale stewardship of Commonwealth funds before deciding on the post-sale arrangements.


OASITO response

1.18 OASITO's response was that it ***agreed with qualifications*** to the recommendation. As to (a), OASITO stated that it already seeks to undertake such an identification, although, in the case of Departmental business units, it is heavily dependent on the relevant agencies for the completeness of the information provided. As to (b), OASITO noted that the custody of the funds in question in this case was primarily a matter for the agencies whose funds were involved.

ANAO comment

1.19 ANAO notes that options for the post-sale treatment of client advances amounting to some \$45.3 million, an amount some 10 times the purchase price of Works Australia, were not identified and progressed as a major sale issue early in the sale process. Accordingly, provisions were not introduced to the sale agreement to ensure the appropriate stewardship of Commonwealth funds until shortly before the sale agreement was signed.

Canberra ACT
18 December 1998



P.J. Barrett
Auditor-General