The Auditor-General

Audit Report No.27
Performance Audit

Sale of DAS Interiors 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 DAS Interiors 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 DAS Interiors 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

P. J. Barrett
Auditor-General

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

AUDITING FOR AUSTRALIA

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Abbreviations/Glossary

ANAO	Australian National Audit Office
CPA	Commonwealth Public Account
DAS	Former Department of Administrative Services
DAS Interiors	DAS Interiors Australia
DOF	Former Department of Finance
DOFA	Department of Finance and Administration
Interiors	Interiors Australia
MBO	Management Buy Out
OASITO	Office of Asset Sales and IT Outsourcing
RFT	Request for Tender

Summary and Recommendations

Summary

Background

1. DAS Interiors Australia (hereafter referred to as 'DAS Interiors') was a Commonwealth owned and operated business that provided a range of services covering strategic advice and accommodation planning, design and documentation, and supervision of office fit-outs. It also offered specialist advice on heritage building interiors and high-technology secure engineering services. DAS Interiors 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 DAS Interiors 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. In March 1997, OASITO's Business Adviser completed the scoping study for the sale of DAS Interiors which identified options for either complete or partial sale of DAS Interiors and / or closure of the whole or part of the entity. The Business Adviser advised OASITO that the achievement of a sale price equal to the book value of DAS Interiors' net assets would be an excellent outcome, with a likelihood that potential purchasers would discount the net assets for unwanted fixed assets and leases.

4. In late February 1997, Registrations of Interest in DAS Interiors were received from 20 interested parties. Six of these proceeded to the next stage and submitted an Expression of Interest. Five Expressions of Interest were shortlisted to bid for DAS Interiors however only one bid was received, from a group of DAS Interiors senior managers — the Management Buy Out (MBO) group. The Commonwealth had provided funding to the MBO group for the purpose of ensuring that they had appropriate commercial advice on the development of their proposal.

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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.

5. The sale of DAS Interiors was selected for audit because it involved an MBO, a feature not present in Commonwealth asset sales considered by previous ANAO performance audits. ANAO also audited the sale of DASFLEET and the sale of Works Australia. Separate audit reports have been produced on overall sale management; the DASFLEET sale; and the Works Australia sale.

Audit conclusions

6. DAS Interiors was sold to an MBO group for a purchase price of $100 000 which was considerably less than the book net assets as of 12 September 1997 of $925 000. In addition, the Commonwealth granted various property concessions to the purchaser which were capped at a maximum of $700 000. ANAO did not sight evidence that either the Business Adviser or OASITO analysed the MBO group's bid in terms of its prospects for medium to long term viability, such that the privatised entity would have the capacity to meet the identified needs of Commonwealth clients. There was only one bidder for DAS Interiors. Should this bid not have been accepted, the Commonwealth would have incurred high costs in closing the business. In these circumstances, ANAO considers that the purchase price negotiated with the MBO group represented a <u>preferable</u> outcome for the Commonwealth.

Tender process

7. In a trade sale involving a simultaneous offering of different businesses, there is the potential for combination offers for two or more businesses. Combination offers can be particularly advantageous to the vendor where they offer a premium over individual offers. Developing a strategy to take advantage of this opportunity can therefore assist in achieving sale objectives. In particular, such a strategy can maximise the field of potential bidders.

8. The tender shortlisting process did not appear to consider the merits of a combination Expression of Interest lodged for the joint acquisition of Works Australia (a profitable business) and DAS Interiors (which was unprofitable at the time of the sale). The potential bidder was shortlisted for DAS Interiors, but not for Works Australia and, subsequently, did not submit an offer for DAS Interiors.

Management Buy Out risks

9. Among the risks involved in the disposal of a Commonwealth business unit to an MBO group are risks to fair and open competition. These can arise through the scope for a preferential position for an MBO in accessing unpublished information. From the time that the MBO group registered an interest in acquiring the business until conclusion of the sale in September 1997, managers of DAS Interiors, who remained in line positions during the sale period, were faced with the potential for conflicts of interest, albeit in this case the MBO bid was the only bid received.

Administrative practices

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

- ***Tendering practices:*** Developing tender strategies to take advantage of combination offers for two or more businesses can maximise the field of potential bidders. In particular, by clearly identifying and separately evaluating combination and individual offers, the best combination offer for each group of businesses can be compared to the best grouping of individual offers for these businesses.
- ***Management Buy Out risks:*** There is the potential for conflicts of interest to arise in the management of a sale entity's assets during the sale period where a MBO group participates in the tender process. Early identification and effective management of Management Buy Out risks would benefit the Commonwealth by minimising post-sale risk and maximising competition in the tender process.

Recommendations

11. ANAO made two recommendations. The Department of Finance and Administration (DOFA) agreed with Recommendation No.2. 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 agencies. More detailed responses are shown in the body of the report together with the findings.

Recommendation No.1 Para 1.19	ANAO *recommends* that, in future simultaneous trade sales, the Office of Asset Sales and IT Outsourcing consider a tender approach which takes advantage of combination offers to assist in maximising competitive pressures. ***OASITO***: Agreed with qualifications.
Recommendation No.2 Para 2.18	ANAO *recommends* that, in trade sales involving a Management Buy Out, agencies implement procedures, at an early stage, to identify and effectively manage financial and other risks to the Commonwealth arising from potential conflicts of interest in the management of the sale entity's assets during the sale period. ***DOFA***: Agreed. ***OASITO***: Agreed with qualifications.

Audit Findings and Conclusions

1. Tender process

This chapter examines the tender process for DAS Interiors.

Background

1.1 The sale of DAS Interiors[2] on 12 September 1997 to a Management Buy Out (MBO) group represents one of the few occasions where the Commonwealth has opted for this form of trade sale. MBO's present the Commonwealth with different risks to those involved in other forms of trade sale. In a sale where the potential exists for an offer from an MBO group, it is particularly important that processes for open and fair competition in offers are established and the privileged position of an internal bid is addressed. Issues which may require attention include identification and targeting of potential bidders and ensuring the provision of information that allows potential purchasers to compete on an equal footing.

1.2 DAS Interiors Business Unit provided a range of services covering strategic advice and accommodation planning, design and documentation, and supervision of office fit-outs. It also offered specialist advice on heritage building interiors and high-technology secure engineering services. At the point of sale, it had 40 permanent staff half of whom accepted redundancy while the other half chose retraining and/or redeployment. In addition, there were a further twenty contract staff.[3]

1.3 In 1995–96, when the decision to sell DAS Interiors was made, the business unit had gross operating revenue of $19.2 million, 45 per cent of which was generated from consulting fees while the remainder came from project management fees. DAS Interiors' operating revenue was largely generated by the ACT office (65 per cent in 1995–96), the remaining revenue being spread across five State offices and an engineering unit. During the first half of 1996–97, DAS Interiors suffered a decline in gross revenue and at 12 September 1997 (the date of sale completion) it had an operating deficit of $0.6 million.

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2 In this report, the term 'DAS Interiors' is used to distinguish the DAS business unit 'DAS Interiors Australia' from the post-sale entity, Interiors Australia Pty Ltd.

3 At the time it was advertised for sale DAS Interiors had 78 staff, of whom 46 were permanent employees.

Audit approach

1.4 The objectives for the audit were to review the efficiency and effectiveness of the conduct of the sales process for DAS Interiors. 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 $43 000.

1.5 The sale of DAS Interiors was selected for audit because it involved an MBO, a feature not present in Commonwealth asset sales considered by previous ANAO performance audits. ANAO also audited the sale of DASFLEET and the sale of Works Australia. Separate audit reports have been produced on overall sale management; the DASFLEET sale; and the Works Australia sale.

Sale management

1.6 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 DAS Interiors 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.

1.7 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;

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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.

- 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.

1.8 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

1.9 In March 1997, OASITO's Business Adviser completed a scoping study for the sale of DAS Interiors which identified options for either complete or partial sale of DAS Interiors and/or closure of the whole or part of the entity. The Business Adviser advised OASITO that the achievement of a sale price equal to the book value of DAS Interiors' net assets would be an excellent outcome, with a likelihood that potential purchasers would discount the net assets for unwanted fixed assets and leases.

1.10 Working on assumptions which included that the business would do neither worse nor better in the full 1996–97 financial year than it had in the first half of the financial year, the Business Adviser's March 1997 Scoping Study estimated[6] that closure of the business would cost the Commonwealth $2.2 million. The Business Adviser also advised that closure

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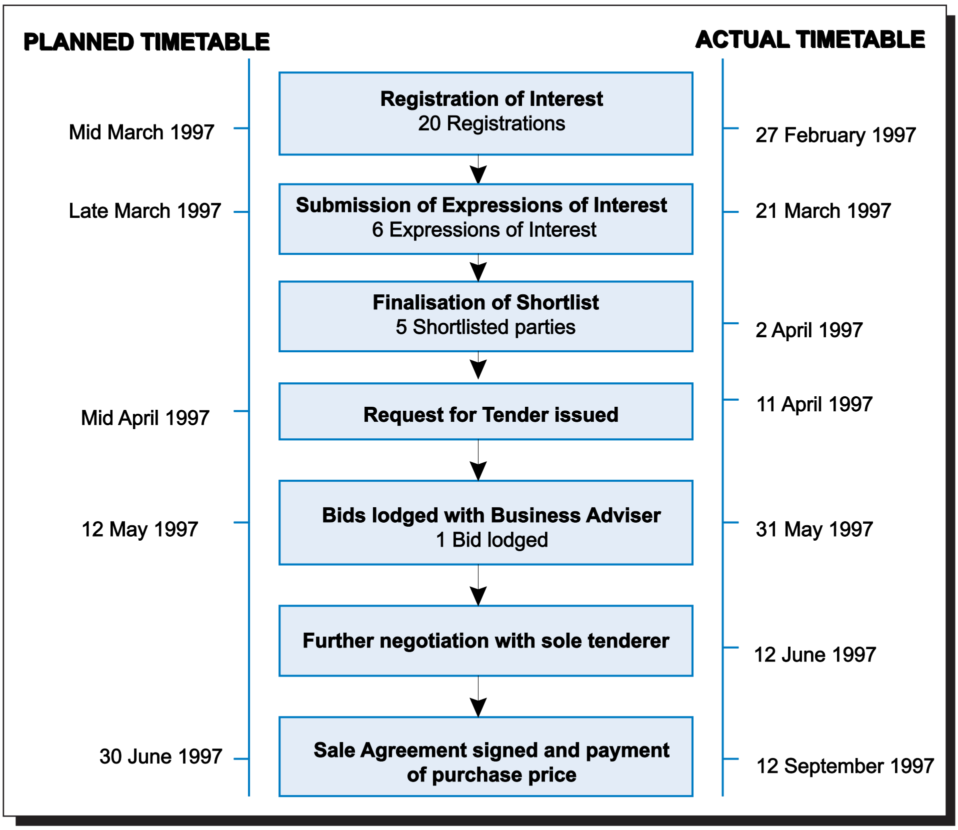
[5] The Committee's terms of reference included: identifying, reviewing and resolving relevant policy decisions; ensuring the information memoranda and data packs contained no material omissions or false or misleading statements; and ensuring the information memoranda included all information purchasers 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 Business Adviser's scoping study had valued closure of the business by assessment of the present value of private leases used by DAS Interiors and the cost to complete the current work in progress.

at this point in time would be severely detrimental to the overall DAS business sale process in terms of staff morale and may result in a higher economic cost. Against this background, the decision was taken to proceed with the sale process for DAS Interiors. Figure 1.1 outlines the major stages, shortlisting of interested parties and the time taken compared with the planned timetable.

Figure 1.1
Tender Process



Source: ANAO analysis of information provided by OASITO.

1.11 In late February 1997, Registrations of Interest in DAS Interiors were received from 20 interested parties. Six of these proceeded to the next stage and submitted an Expression of Interest. Correspondence from another interested party which ‘expressed’ interest in DAS Interiors was not included in the Business Adviser’s assessment of Expressions of Interest as the Business Adviser deemed it merely a “registration of interest”. The Business Adviser assessed the six Expressions of Interest against criteria relating to the interested parties’ financial and operational capabilities and their intent in relation to DAS Interiors.

1.12 One of the six proponents was not invited to proceed to tender on the basis of its assessed industry experience and lack of significant capital. The five shortlisted organisations were provided with the Request for Tender (RFT) on 11 April 1997 and invited to tender, having regard to the evaluation criteria set out in the RFT.[7] The RFT stated that the Commonwealth's preference was to sell DAS Interiors in its entirety[8] and required that *conforming bids will therefore be on the basis of acquiring the business in its entirety*. The only bid received and assessed by the Business Adviser for DAS Interiors was from a group of DAS Interiors senior managers (the MBO group) which was submitted on 31 May 1997.[9] The Commonwealth provided funding to the MBO group for the purpose of ensuring that they had appropriate commercial advice on the development of their proposal.

Combination offers

1.13 In a trade sale involving a simultaneous offering of different businesses, there is the potential for combination offers for two or more businesses.[10] Combination offers can be particularly advantageous to the vendor where they offer a premium over individual offers. Developing a strategy to take advantage of this opportunity can therefore assist in

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7 The criteria comprised:

- the price offered;
- the financial capability of the tenderer, including clear evidence of its ability to finance the acquisition and business requirements;
- the operational capacity and experience of the tenderer, including their track record in the industry or experience in managing a similar size business, and the human resources strategy to be adopted in the sale process;
- the assumption of business risks and benefits. This included the extent to which the tenderer would acquire DAS Interiors with all the entanglements, risks and benefits attaching to ownership and the extent of adherence to the draft sale agreement, including of any suggested amendments and pre-conditions to completion; and
- the ability of the tenderer to meet the sale timetable.

8 The RFT notified proponents that the sale would include net assets; assigned contracts, memoranda of understanding and work in progress; assigned lease commitments and intellectual property including trade marks, business names and computer software licences.

9 Another proponent proceeded to the point of participation in a briefing session with the management of DAS Interiors as part of its purchaser due diligence but did not submit a tender.

10 Combination offers involve lodging a tender for two or more businesses on a combined basis. The possibility of combination offers was explicitly provided for in the tender strategy for the 1997 sale of Brisbane, Melbourne and Perth airports; the 1997 sale of the Australian National Railways Commission's intrastate freight and interstate passenger businesses; and the 1998 sale of fifteen Federal Airports. Similar provisions were not included in the tender strategy for the DAS Business Units sales.

achieving sale objectives.[11] In particular, such a strategy can maximise the field of potential bidders.

1.14 In the DAS Business Unit sales one potential bidder lodged a combination Expression of Interest for the acquisition of both DAS Interiors and Works Australia. ANAO considers it is good administrative practice for combination offers to be clearly identified and evaluated separately to individual offers. The best combination offer for each group of businesses can then be compared to the best grouping of individual offers for these businesses.

1.15 The potential bidder intended to acquire both businesses and fully merge them into its existing business. The shortlisting process addressed the combination Expression of Interest as separate individual Expressions for each business and did not appear to consider the merits of the combination Expression of Interest. The potential bidder was shortlisted for DAS Interiors but not for Works Australia (a profitable business). It did not proceed to submit an offer for DAS Interiors.

1.16 OASITO advised ANAO that bid assessment concluded that the joint bidder was not capable of funding a joint acquisition. Further advice from OASITO to ANAO was that:

> *It is not clear that this is a combination bid rather than a dual bid for two businesses contained in one letter. …The issue of a combination bid did not arise because there was probably no combination bid and certainly no viable combination bidder.*

1.17 OASITO's advice does not accord with ANAO's review of the Expression of Interest lodged by this potential bidder and of the financial assessment of this potential bidder. The potential bidder stated in its Expression of Interest that it is *our intention to acquire both businesses fully and merge them with* [the bidder's existing business]. The Business Adviser's shortlisting recommendations stated that the potential bidder was not shortlisted for Works Australia *due to* [its] *small turnover compared with other Expressions of Interest. …No financials were provided.*

1.18 **Finding:** The tender shortlisting process did not appear to consider the merits of a combination Expression of Interest lodged for the joint acquisition of Works Australia and DAS Interiors. The potential bidder was shortlisted for DAS Interiors, but not for Works Australia and, subsequently, did not submit an offer for DAS Interiors.

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[11] For example in the sale of Brisbane, Melbourne and Perth Airports, provision was made in the Request for Tender for combination offers and a number of combination offers were received and evaluated as combination offers in addition to evaluating the component offers for the individual airports.

Recommendation No.1

1.19 ANAO *recommends* that, in future simultaneous trade sales, the Office of Asset Sales and IT Outsourcing consider a tender approach which takes advantage of combination offers to assist in maximising competitive pressures.

OASITO response

1.20 OASITO's response was that it ***agreed with qualifications*** to the recommendation. OASITO noted that such an approach was adopted in this and other relevant sales, but OASITO is only prepared to consider combination offers that the proponent can clearly fund.

ANAO comment

1.21 A key strategy in any trade sale is to maximise the level of competition for the business being offered for sale. In simultaneous sales of different businesses, this can be assisted by marketing the possible synergistic benefits of acquiring more than one business, and identifying the best combination and individual proposals across all possible ownership permutations to determine the best overall result for the Commonwealth. Given the financial performance and position of the DAS Interiors business at the time of the sale, ANAO considers greater attention could have been paid to developing tender strategies and a tender evaluation approach for potential combination bids for this and the other DAS businesses.

2. Sale outcomes

This chapter examines the major outcomes from the sale of DAS Interiors to a management buy out group.

Sale outcomes

2.1 The Request for Tenders (RFT) advised potential bidders that *the sale process has been designed to provide for completion of the sale on or before 30 June 1997*. The sale was completed on 12 September 1997, three months later than forecast in the RFT. The Minister for Finance approved the sale to the MBO group on the basis of advice from OASITO and its Business Adviser that sale on the negotiated terms was a better outcome for the Commonwealth than closure of DAS Interiors.

Value to the Commonwealth

2.2 The sale of DAS Interiors was forecast in the August 1996 Budget estimates to realise proceeds of $700 000[12]. In contrast, the March 1997 scoping study estimated that the sale of DAS Interiors at net asset value would involve a net cost of $360 000.

2.3 The MBO group had initially submitted a negative price which would have involved the vendor paying the MBO group to purchase the business. The MBO group was advised that its initial bid was unacceptable. The Business Adviser wrote to OASITO on 15 July 1997 and advised that:

> *The MBO has offered to pay $100 000 to purchase the business. The net assets and liabilities (included in the sale) of the business are $631 000. The MBO justifies this discount on the basis of the continuing decline in the business' key market and profitability and the loss of credibility the business has suffered with major customers due to uncertainty associated with the sale process. We believe the absence of alternative tenderers for the business is consistent with the MBO's market assessment and supports a price below net assets.*

2.4 At the time of sale, DAS Interiors had neither a strong asset base nor a strong income stream. The scoping study warned that a tender by an MBO group would need *to be fully evaluated as to its medium to long term viability to ensure that the privatised entity did not collapse in tough market conditions*. ANAO did not sight evidence that either the Business Adviser

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[12] The 1997–98 Budget revised the forecast to zero.

or OASITO analysed the MBO group's bid in terms of its prospects for medium to long term viability, such that the privatised entity would have the capacity to meet the needs of Commonwealth clients. OASITO has advised ANAO that, because there was no long-term contractual relationship with the Commonwealth, the post-sale financial viability of the MBO was not a relevant consideration.

2.5 The options available, given that there was only one bidder, were to proceed with a sale to that bidder or to close the business down. The Business Adviser's revised estimate put the costs of closure at between $2.54 million and $3.14 million. The sale to the MBO group was considered a preferable outcome for the Commonwealth compared to the closure of the business.

2.6 The final negotiated position was that the MBO group received lease and fit-out benefits from the Commonwealth in return for a sale price of $100 000. At completion of the sale on 12 September 1997, DAS Interiors' assets and liabilities statement reported that the business' net assets were valued at $925 000.

2.7 The RFT indicated that a purchaser would be required to accept assets and leases on the basis of 'as is—where is'; that is, with no substantive change to the condition and location of the assets and leases. It had notified that tenderers may be excluded from the tender process if, subsequent to their RFT submission, they indicated the need for substantive amendments to the draft sale agreement. Notwithstanding this, the MBO group achieved better terms and conditions than those notified in the RFT, including payment by the Commonwealth of rent subsidies and revised lease arrangements and compensation to the purchaser for book debts which remained uncollected by the purchaser three months after the sale completion date. The Business Adviser's recommendation that the sale to the MBO group proceed, as submitted to OASITO in July 1997, valued the property concessions at $700 000.

2.8 **Finding:** DAS Interiors was sold to a MBO group for a purchase price of $100 000 which was considerably less than the book net assets as of 12 September 1997 of $925 000. In addition, the Commonwealth granted various property concessions to the purchaser which were capped at a maximum of $700 000. ANAO did not sight evidence that either the Business Adviser or OASITO analysed the MBO group's bid in terms of its prospects for medium to long term viability, such that the privatised entity would have the capacity to meet the needs of Commonwealth clients. There was only one bidder for DAS Interiors. Should this bid not have been accepted, the Commonwealth would have incurred high costs in closing the business. In these circumstances, ANAO considers that the purchase price negotiated with the MBO group represented a preferable outcome for the Commonwealth.

Post sale Commonwealth risk

2.9 Following the sale of DAS Interiors the Commonwealth continued to carry short term risks associated with the capacity of the new entity to acquit pre-existing contracts with Commonwealth clients to an appropriate standard; the Commonwealth's contractual liability for warranty claims; the collection of debts due to the Commonwealth by the purchaser following the sale; and the handling of funds advanced to DAS Interiors by clients.[13]

2.10 At the time of the sale, DAS Interiors held monies advanced from clients funded through the Commonwealth Public Account (CPA) towards the costs of current projects. The sale agreement required the purchaser to provide a bank guarantee[14] or an unconditional parent company guarantee, where appropriate, to secure all client advances assigned to it. Under the sale agreement, access to the client advances is on the basis of a request from the purchaser, which is supported by an audit certificate as to the bona fide status of the disbursements for which the request has been prepared, to be approved by the then Department of Administrative Services. All affected clients of DAS Interiors were asked to review the nature of their agreement with it, with an option to request return of advanced funds if they did not wish to have advanced funds transferred to the new owners.

2.11 The purchaser was required to indemnify the Commonwealth against any action, suit, claim or demand made in relation to a client advance transferred to the purchaser in the sale process. This obligation continues in force until all client advances paid to the purchaser are acquitted.

Management Buy Out risks

2.12 Among the risks involved in the disposal of a Commonwealth business unit to a management buy out group are risks to fair and open competition. These can arise through the scope for a preferential position

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13 For further discussion of the issue of the transfer of client advances to purchasers see Audit Report No.26 1998–99, *Sale of Works Australia,* p.21-23.

14 The purchaser provided a bank guarantee for $7.07 million in respect of client advances paid to them by the Commonwealth. Source: OASITO's Annual Report 1997–98 p.22.

for an MBO group in accessing unpublished information. To avoid potential conflict of interest between official duties and personal business interests in the processes for an MBO, steps are needed to quarantine interested staff within a business from opportunity to gain unfair advantage in terms of access to information and resources, and at the same time to ensure access to a consistent flow of information for all bidders. At the time that the selected DAS businesses were advertised for sale, a protocol for the handling of information requests and contacts with potential purchasers was established by DAS and promulgated in a staff news bulletin. The DAS guidelines envisaged staff involved in an MBO bid moving off-line for the duration of the sale process.

2.13 The MBO group's funding proposal addressed conflict of interest in terms of using the services of a business adviser as the promoter of the buy out; use of historic reporting procedures and detailed budgeting as a review mechanism and to provide an audit trail; and conduct of communications relating to the MBO offer outside normal business hours. The MBO proposal argued that it was impossible to take staff off-line to act for the MBO group, because it would exclude key staff from fee earning and marketing activities and jeopardise the viability of the business leading up to sale.

2.14 The MBO group's position was accepted. The effect of this decision was to place managers of DAS Interiors in circumstances of potential conflict of interest during the period between the MBO group's registration of interest in acquiring DAS Interiors (April 1997) and conclusion of the sale (September 1997). DAS issued guidance, *Ethics on the Conduct of Management/Staff Buy-outs* which advised that employees may not knowingly take advantage of, or benefit from, information that is obtained in the course of their official duties and responsibilities that is not generally available to the public. It stated that similar ethics should apply in respect of management / employee buy-outs as to a company in respect of insider trading.

2.15 DAS was also aware of the potential during the sale period for general non capital funds to be diverted to purchases such as computing and office equipment and excessive stock accumulation which could benefit an MBO in the post-sale period. In January 1997, a proposal was considered that purchase of equipment such as photocopiers, facsimile machines, tools and large stock orders should be approved by DAS central office but this was rejected as administratively impractical.

2.16 DAS Interiors managers were advised on 24 July 1998 that discretionary expenditure should cease. Subsequently, they were advised that they should act in a caretaker capacity.[15] Pending material tenders and draft contracts were to be notified to the Commonwealth's Legal and Business Advisers.[16]

2.17 **Finding:** Among the risks involved in the disposal of a Commonwealth business unit to a MBO group are risks to fair and open competition. These can arise through the scope for a preferential position for an MBO in accessing unpublished information. From the time that the MBO group registered an interest in acquiring the business until conclusion of the sale in September 1997, managers of DAS Interiors, who remained in line positions during the sale period, were faced with the potential for conflicts of interest, albeit in this case the MBO bid was the only bid received.

Recommendation No.2

2.18 ANAO *recommends* that, in trade sales involving a Management Buy Out, agencies implement procedures, at an early stage, to identify and effectively manage financial and other risks to the Commonwealth arising from potential conflicts of interest in the management of the sale entity's assets during the sale period.

DOFA response

2.19 DOFA's response was that it ***agreed*** with the recommendation. DOFA noted that the executive of the (former) Department of Administrative Services in conjunction with Australian Government Solicitor issued a document entitled—Ethics for the conduct of Management/Staff Buy Outs designed to ensure propriety, integrity, and probity and avoid conflict of interests in the sales process.

OASITO response

2.20 OASITO's response was that it ***agreed with qualifications*** to the recommendation. OASITO noted that under current accountability arrangements, the proper operation of a Departmental business unit

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15 Limited delegations were also put in place for:

- *capital expenditure*: no authority for any capital expenditure including expenditure on furniture and equipment;
- *contracts*: no authority to enter into contracts over $10 000 fee value without the written consent of the purchaser;
- *tenders*: no authority to sign bids over $10 000 in fee value without the written consent of the purchaser;
- *contract staff*: no authority to enter into any new contracts that extend beyond the sale date; and
- *APS staff:* no authority for recruitment.

16 DAS Interiors notified a short-term contract for maintenance services for plotter equipment and a proposal to buy a mobile telephone.

pending sale is a matter for the ‘owning’ Department, and that OASITO’s capacity to manage the associated risks can be limited by the relevant Department’s practices.

Canberra ACT
18 December 1998

P.J. Barrett
Auditor-General

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